STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 99-851

June 25, 2001

MAINE PUBLIC UTILITIES COMMISSION
Investigation into Verizon Maine's Alternative Form of Regulation

ORDER (Part 2)

WELCH, Chairman; NUGENT and DIAMOND, Commissioners

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I. SUMMARY AND INTRODUCTION

In this Order we extend the Alternative Form of Regulation (AFOR) for Verizon Maine (Verizon) until May 31, 2006.[1] We modify the plan by allowing Verizon additional pricing flexibility. We also allow the Company to raise its basic local rates by $12.5 million annually to balance the recent access reductions required by Maine law. Basic rates will increase by $1.78 per line per month, except for Centrex lines, which increase by approximately one-third of the full per-line increase, and flat-rated PBX trunks, which increase by 150% of the per-line amount.[2] Basic service provided for resale will continue to be subject to the existing wholesale discount contained in the reseller's interconnection agreement. The rates for customers served under Lifeline rates will not increase.

We will not allow Verizon to increase basic rates to offset any future lost retail toll revenues because we expect that continuing productivity gains and revenue increases from other services will equal or exceed the amount of any such lost toll revenues. We will, however, require the Company to make a filing showing either that it has experienced an actual revenue decrease from retail toll services of $19.8 million or that it has reduced its rates by that amount. If the Company cannot show that its intrastate toll rates and/or revenues have decreased by $19.8 million, the Commission may require Verizon to file tariff changes to bring about the remainder of the reduction.

Beyond the initial increase no increases for basic rates for inflation will be permitted during the term of the AFOR. Barring adjustments for exogenous events, those rates will remain capped through May of 2006. We also cap the charges for two other services (Directory Assistance and Operator Service) that currently do not exhibit effective competition. We will allow the Company at any time during the remainder of the AFOR to present evidence to the Commission that effective competition exists for multi-line (defined as 10 or more access lines) business customers on a wire center or an exchange basis. If the Commission finds that effective competition is present in the wire center or exchange, Verizon will no longer be bound by the cap for multi-line business customers in that wire center or exchange.

For all other retail services, the Company has pricing flexibility, but we will open a proceeding shortly that will examine whether optional calling features exhibit characteristics that require some form of price regulation. Because the Company retains a virtual monopoly over the residential and small business customer market, and because most of the optional calling features cannot be obtained from another source, the Commission will examine the need for some level of price protection for these services. Rates for intrastate access service will continue to be set in accordance with

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[1]The Procedural History of this Investigation is contained in Appendix A.

[2]Chairman Welch's separate concurring opinion on this subject appears at the end of this Order.

the provisions of 35-A M.R.S.A. § 7101-B, and wholesale rates will remain subject to the provisions of the Telecommunications Act of 1996 (TelAct).

The revised AFOR will have a term of five years. 35-A M.R.S.A. § 9103 (1) states that "the alternative form of regulation…may not be less than 5 years nor exceed 10 years without affirmative reauthorization of the commission…." We initially ordered that the first phase of the AFOR would be in effect for five years (from December 1, 1995 to November 30, 2000), but we extended that term for an additional half year. Accordingly, the two phases of the AFOR will be in effect for a total of 10½ years. We therefore expressly affirmatively reauthorize the AFOR for an additional five years, for a total of 10½ years.

During the next five years we anticipate that competition will likely become the major factor in shaping the telecommunication industry and the way that Verizon conducts business in Maine. While we recognize that ubiquitous competition for all types of customers and services may be slow to develop fully in Maine, which has many high-cost exchanges, we will take all reasonable steps to ensure that economic competition develops as quickly as is reasonably possible. We recognize, however, that we cannot force competition to materialize and take hold when it is not economically justified.

We also will continue the Service Quality Index (SQI) mechanism that we adopted for the initial phase of the AFOR, but we modify certain attributes of the plan. We increase the total number of indices to 15, increase the maximum amount of penalty applicable to each metric, and increase the total amount of annual penalty for which the Company may be liable. Each index, except the Service Outage index, will have a maximum annual penalty of $1.135 million. The Service Outage metric annual maximum penalty will be $2.27 million, and the maximum total annual penalty will be $12.5 million. We also eliminate four of the current measures, change four (including separating a current single measure into two separate metrics) and add five new indices. For the new indices, we will calculate the baseline measurements from the most recent 3-year average data, but we retain the existing baselines for the five unchanged indices.

II. BACKGROUND AND OVERVIEW

A. The First Phase of the AFOR

The Commission adopted the AFOR in 1995 for a 5-year period, later extended for an additional half year. This phase of the AFOR terminated on May 31, 2001. (Throughout this Order we refer to the AFOR in effect from December 1, 1995 to May 31, 2001 as the "initial phase" or the "first five years" of the AFOR). During its term, Verizon's core rates have been reduced by an average of 12.5%. While basic rates were increased by $3.50 in three steps as a result of a stipulation to allow the Company to offset part of the reductions to access rates mandated by Section 7101-B, we believe that ratepayers today are the same or better off than they would have been without the implementation of the AFOR, as required by 35-A M.R.S.A. § 9103(1). The most significant price decreases have been in toll, due to the access charge reductions and the substantial level of competition in the toll market.

Since we implemented the AFOR, two major new laws, one Federal and one State, have significantly affected the telecommunications industry. The Federal Telecommunications Act of 1996 (TelAct) provided the basis and terms under which local exchange service was fully opened to competition. The TelAct set forth the principles under which competitors could enter the local exchange market by using their own facilities interconnected with those of the incumbent local exchange carrier (ILEC), or by using all or portions of the ILEC's local network facilities (by purchasing Unbundled Network Elements, or UNEs), or by reselling the ILEC's local service in its entirety. The TelAct established the obligations of ILECs to make their services and facilities available to competitors, and it spelled out the procedures that must be followed in reaching agreements for interconnection, use of UNEs or resale. The TelAct continued the Modified Final Judgment (MFJ) prohibition against (RBOCs) provision of interLATA traffic by the former Bell operating companies within their local service territories until they proved that their local markets were opened completely to competition.

The second change in law occurred in 1997. The Maine Legislature enacted 35-A M.R.S.A. § 7101-B, which requires "access parity", i.e., every Maine LEC's intrastate access charges must be less than or equal to its interstate access charges. Although the access parity statute was enacted in 1997, it required LECs to make their first access charge reductions on May 30, 1999, about three and a half years after the AFOR began.

The anticipated effect on Verizon's access and toll revenues of the access parity statute led to the Commission's acceptance of a stipulation that increased basic exchange rates in a 3-step process (which involved a waiver of the original AFOR pricing rules governing basic exchange service rates) but decreased intrastate access rates to their interstate level on May 30, 1999, as required by the statute. The statute requires that intrastate access rates be readjusted every two years to levels that are equal to or less than the federal levels. The second adjustment occurred on May 30, 2001.

While the statute directs the Commission to take action regarding access rates, the intent of the statute is to remove one of the major impediments to lower intrastate toll rates. Under subsection 3, the Commission has the authority to require that the access rate reductions be passed along to consumers through lower toll rates if it finds that effective competition does not exist in the in-state toll market. To date, the Commission has not found it necessary to use its authority to lower toll rates, as the available evidence suggests that effective competition is present in this market.

B. Consideration of Statutory Objectives for the Revised AFOR

The Commission must consider revisions to the AFOR with these changes in the telecommunications environment in mind. The Commission remains committed to relying on competitive forces to guide the telecommunications marketplace in Maine, but we must ensure that consumers are protected with respect to services whose markets are not yet effectively competitive. Against this background, we turn to a review of the AFOR standards set forth in 35-A M.R.S.A. §§ 9101 – 9105.

Section 9103 sets forth nine objectives. In our AFOR Order in Docket 94-123, we found that the AFOR met, or was very likely to meet, each of those objectives. In the Further Notice of Investigation (FNOI), issued in this Docket on June 26, 2000, we described how the AFOR, with the proposed revisions, would continue to satisfy the provisions of the statute. Nothing we do in this Order by way of modifying the AFOR alters our conclusion, reached previously, that both the initial and revised AFOR fully meet all nine objectives, and we will not repeat our discussion of all of those objectives here. We will, however, expand on our analysis of some of those requirements.

The first objective requires that the term of the AFOR not exceed ten years nor be less than five years, and that residential and small business ratepayers not be required to pay more for local service as a result of the implementation of the AFOR than they would under traditional rate base or rate of return regulation. In our original AFOR Order, we also decided that toll rates should also be priced as low or lower under an AFOR than they would under traditional regulatory ratemaking principles.

During the initial phase of the AFOR, most of the rate reductions required under the operation of the price cap mechanism (the "Price Regulation Index" or PRI) went to the toll market, which is the most competitive telecommunications market in Maine. During that first phase, we also approved a stipulation that contained, as one part, an increase to basic exchange rates, notwithstanding the AFOR pricing rule that prohibited increases to basic local rates unless the PRI was positive. (The PRI never was positive during the 5 ½ years of the initial AFOR). The increase to basic rates, therefore, was not the result of the operation of the AFOR. Instead, it was the product of the statutory mandate that intrastate access rates be set equal to those established by the FCC for interstate access. Implementing the statutory mandate resulted in a significant decrease in intrastate access and toll revenues for Verizon, and the Commission found it reasonable to allow the Company to offset a portion of the estimated revenue loss with an increase to basic exchange rates, largely because only basic exchange rates could produce sufficient revenues to offset the effects of implementing the statute.

In this proceeding we were again faced with the need to adjust intrastate access rates downward on May 30, 2001, in order to comply with the provisions of Section 7101-B. The decrease is smaller than the one associated with the 1999 adjustment, but still will result in a significant reduction in the Company's revenues. As we did in 1999, in this Order we allow Verizon to increase its basic rates to offset a portion of the revenue reductions that will result from the access parity statute. Our action here complies fully with the fifth objective of Section 9103, which requires that customers pay only "reasonable charges for local telephone services," when taken together with the sixth objective, which states that an AFOR must ensure that the telephone company has "a reasonable opportunity to earn a fair return on the investment necessary to provide local telephone services."

The Commission is obligated to consider the interests of both ratepayers and the Company when it establishes local rates under an AFOR, and we have continued that balancing of interests in the revised plan. Local rates remain reasonable, and customers are protected from additional increases. Customers also should see the benefits of reduced toll rates, while the Company is given the opportunity to earn a reasonable return on its investment necessary to provide local service. It is also given pricing flexibility for its optional calling services, which will allow it to price these services at levels that will optimize its revenue. Further, to the extent that the Company can become more efficient while maintaining its service quality at acceptable levels, it will keep the rewards. Conversely, if the Company is not efficient or if it loses customers to competitors, it will not (except under extraordinary circumstances) be permitted to ask the Commission to assist it in reviving its earnings.

In this docket the Company has made several assertions about its inability to increase its revenues and, consequently, its earnings, given the general condition of the economy in Maine and the changing telecommunications environment. We decline to rely to any extent on these assertions. Indeed, the Company's position here is ironic in light of its vigorous opposition to the Public Advocate's request to conduct an earnings investigation for Verizon. In rejecting the Public Advocate's request, we made clear that we did not consider Verizon's revenue requirement or earnings to be relevant to the issues involved in continuing and revising the AFOR.

We reiterate that earnings are irrelevant to the form of the revised AFOR. Nevertheless, Verizon's claims should not go unanswered. First, we observe that over the five years ending in December, 2000 , the Company's intrastate earnings grew at an average annual rate of 5.7%, even though its revenue growth averaged only 2.6%. Apparently, the Company has been able to generate enough efficiencies in its operations to overcome the AFOR-induced rate reductions of about 12.5% during the initial phase of the AFOR. Based on its reported results during the initial phase of the AFOR, the Company cannot claim that its financial results have been unacceptable, especially when compared to what might have occurred under rate of return regulation. We firmly reject any policy that would employ incentive regulation only when a utility's business is prosperous, but would revert to a rate of return approach when earnings decline.

In summary, there is no evidence to support any claim that the Company has been disadvantaged financially by the initial phase of the AFOR, or to support the claim that the Company will not have a continued opportunity to perform well financially in the future, provided it can operate efficiently (while maintaining acceptable levels of service quality) and meet the competitive threats of the marketplace. The telecommunications market may be shifting, but there is no evidence indicating that it is a long-term declining market, and Verizon has every opportunity to participate and prosper in that market.

The Company also claims that its growth rate in access lines has turned negative, as cable modems replace second lines for Internet usage and competitive LECs pursue the Company's most lucrative business customers. The Company appears to be suggesting that it has no growth opportunities left in the telecommunications area. While the Company's traditional sources of revenue may decline in the future, we expect that, as in the past, new opportunities for increased revenues will continue to emerge in the telecommunications industry, especially for a company that already has in place a ubiquitous and vibrant infrastructure.

Finally, we discuss two other objectives contained in Section 9103 that are related in purpose: number 4 ("Safeguards") and number 7 ("Encourage telecommunications services"). The fourth objective requires that the AFOR protect local service subscribers from the risks associated with the "development, deployment and offering of telecommunications and related services offered by the telephone utility, other than local service;" it also requires that the utility continue to offer a "flat-rate, voice-only local service option." Objective number 7 requires the AFOR to "encourage the development, deployment and offering of new telecommunications and related services in the State."

The initial phase of the AFOR accomplished these objectives in part by permitting limited or no increases to local service rates, although we did permit one exception to that rule because of the requirements of the access parity statute. The revised AFOR accomplishes these objectives in part by allowing Verizon to increase its basic rates by only a portion of the amount necessary to offset the revenue losses from mirroring interstate access charges. Both the initial phase and the revised AFOR allow the Company a reasonable opportunity to earn a fair return on its local network investment. The initial phase of the AFOR allowed the Company complete pricing freedom on all new services, by making them non-core services, and excluded them from the rates that were subject to the PRI, thus insulating local ratepayers from the risks of those services. The revised AFOR expands the pricing flexibility afforded Verizon, in that the Company is allowed to adjust the prices in any direction for almost all its services without price cap restrictions. Verizon has the ability to price its discretionary services at the level that will maximize its revenues; it can compete with alternative service providers; and it can offer advanced services through its affiliate, VADI, subject to FCC merger conditions. Verizon assumes the risks and earns the rewards of its actions according to its ability to offer services and products that customers will buy.

The Executive Branch (EB) agencies of the State of Maine have proposed that we adopt specific infrastructure investment requirements for Verizon to ensure that telecommunications technology in Maine is similar to that deployed by Verizon in the more urban parts of its service territory. We decline to adopt that proposal as discussed in greater detail in Part VIII.

III. AFOR STRUCTURE; PRICING RULES

A. Basic, Directory Assistance and Operator Services

As we proposed in the FNOI, we will not adopt a price index (e.g., a PRI) for any group of services. Three retail services (basic local exchange, directory assistance, and operator services) will be subject to direct price regulation by the Commission; the Company will not be allowed to raise prices for those services except as described below. Access and wholesale services will be subject to regulation pursuant to statutes. The Company will have pricing flexibility for all other services. Depending, however, on findings we make in a proceeding that we will conduct to address whether certain optional calling features have become “basic” or essential, we may decide that some form of price regulation is necessary for some or all of those services. While we do not adopt a PRI that contains a formal recognition of productivity gains, we find that productivity for Verizon will continue to increase. We rely on those productivity gains (along with increases to revenues for other services) to offset expected decreases to retail toll revenues. We explain our reasons for this decision in Part V.

During the term of the revised AFOR, we will not allow Verizon to increase its rates for basic exchange service beyond the increases specified in this Order to offset the access rate reduction that occurred on May 30, 2001. We will, however, as described below, permit Verizon pricing flexibility if it establishes that reasonable competitive alternatives exist for segments of the local exchange market. Based on the testimony of Public Advocate witnesses Norton and Sweet, we cannot find at this time that there is any effective local exchange competition for local exchange customers with the possible exception of business customers with large numbers of lines.

We also will not allow Verizon to increase its prices for operator or directory assistance (DA) services, unless Verizon can show a cost basis for such a change or that either of these services has become competitive. We describe our reasons for this decision in Part VI.

During the revised AFOR, the Company may present evidence showing that a competitive market exists for residential or business local exchange service, or for operator or directory assistance services. If we find that a competitive market does exist for any of these services (or a subset of any service), we will allow Verizon increased pricing flexibility for that service. In particular, Verizon may attempt to establish that a competitive market exists for local service for multi-line (10 or more) business customers. Verizon may make such a showing on an exchange or wire center basis. At a minimum, Verizon must show that one or more facilities-based CLECs have facilities in place to provide service to customers with ten or more lines, but it also must show that the CLECs are actively marketing and providing their services to such customers. Whether CLECs provide service throughout the entire wire center is another factor we will consider in determining whether competition is effective.

B. Toll and Wholesale Services

For retail toll services we find that there is effective competition. We will permit Verizon pricing flexibility for those services. We find that the retail toll market has been effectively competitive for several years. Verizon may change its rates for all retail toll services at any time, provided it files tariff changes with the Commission and provides notice to customers as required by statute or Commission rules. Verizon must, however, meet the revenue or rate reduction requirements described in Part V.

Rates for all wholesale services will continue to be set in accordance with statutory provisions. Rates for intrastate access are governed by Section 7101-B, and wholesale rates for unbundled network elements, interconnection and local resale are subject to the provisions of the TelAct.

C. Optional and Enhanced Services

Optional and “enhanced” services constitute a large category of Verizon services. These services include optional services such as call waiting, call forwarding and three-way calling, as well as CLASS services such as caller ID. There are few competitive alternatives for most of these services. They can be obtained only from the LEC that provides the customer with local service; it is not possible to obtain local service from one LEC and optional calling features from another. For most of these services there are no reasonable substitutes available from non-LEC sources. Answering machines may serve as a substitute for voice mail, but have the disadvantage that it is not possible for a caller to reach an answering machine if the line is busy.

Nevertheless, despite the fact that competitive alternatives for many of these alternative services are scarce, it is possible to find (as we did under the present AFOR) that they are “discretionary” in nature and that Verizon should be permitted pricing flexibility. All of these services are “discretionary,” at least in the sense that they are optional. Customers do not have to take any of these services; they are not included in mandatory bundled packages with basic or toll services. A further meaning of “discretionary” is more relevant to our decision about the degree of regulation that is necessary. A service is “discretionary” if it is one that is not necessary for most customers and is typically characterized by a high elasticity of demand, such that many customers will not purchase (or continue to purchase) the service if the supplier raises the price too much. The nature of the demand for the service contains a built-in check on pricing. In the first five years of the AFOR, we granted Verizon pricing flexibility (subject, however, to the overall price cap of the PRI) for a broad category of services we determined were “core discretionary.” That category included nearly all of Verizon’s services, other than the three whose prices cannot be increased under the revised AFOR, plus retail toll. We also included “new” services in a category called “non-core.” We permitted Verizon total pricing flexibility for those services, not subjecting them even to the overall price cap. New services included Voice Mail and various bundled packages of optional calling features that were otherwise classified as core discretionary.

Under cost-of-service regulation, the prices for these optional services were generally set at levels to “maximize” the contribution from these services to “residually” priced services (generally basic exchange service). The price that a company will set for a product that is subject neither to price regulation nor competition will likely be the same – i.e., a price designed to “maximize” the profit (i.e., “contribution”) from that product. We therefore doubt if there was much difference between the pricing principles that applied to these services under traditional regulation and under the first phase of the AFOR.

Nevertheless, the Public Advocate has suggested that some of the optional calling features have become “essential” and that Verizon should not be permitted total pricing freedom. While we do not believe that the record was sufficiently developed in this case to make a finding about the Public Advocate’s hypothesis, we share the OPA’s concern that customers, in effect, may have redefined basic service to include some of these services. As discussed above, most of these services may be obtained only from a customer’s LEC. Accordingly, it is appropriate to ask whether stricter rate regulation is necessary, and we will open a proceeding to address that question. Until we conclude that proceeding, we will permit Verizon pricing flexibility for those services. Any price increases, however, may be subject to reversal at the conclusion of the proceeding.

D. Other Pricing Principles

As under the present AFOR, Verizon may not price any rate below the long-run incremental cost (LRIC) of providing the service, but the Commission will not investigate any rate decreases unless a complaint is filed that alleges a violation of this rule.

Finally, we will allow Verizon and others to request the recovery or passing through of positive or negative “exogenous” changes in costs or revenues, using the same definition of exogenous changes that we applied during the first phase of the AFOR, after amendment of that definition in the stipulation we approved in Docket No. 94-254 in 1998. Because we apply that definition to two issues in this case (access and toll revenue losses), we provide greater detail in our discussion of those issues at Parts IV and V below.

IV. ACCESS REVENUE REDUCTION; INCREASE TO BASIC RATES

Pursuant to the requirements of 35 M.R.S.A. §7101-B and the rules of this Commission, Verizon must reduce and restructure its intrastate access charges so that they are at or below the level of interstate access charge rates. The OPA estimates that the revenue impact of that reduction will be $8.4 million. Verizon estimates that the reduction in access rates will reduce its access revenues by $14.4 million.

The OPA's estimate of the access revenue reduction assumed growth in access use demand based on past growth trends. Verizon's estimate did not appear to take into account any growth in access minutes.

We find that the OPA's estimate of the loss of access revenues is understated for several reasons. In general, stimulation studies are often quite speculative, and this Commission has been reluctant to rely heavily on them. OPA witness Kahn's growth estimates assume a continued growth in access minutes that probably was caused in part by the introduction of Intra-LATA presubscription (ILP), resulting in migration of some Verizon retail toll customers to other interexchange carriers (IXCs) and an increase in access minutes paid by those carriers. ILP, however, was a one-time event. Dr. Kahn's estimates also do not recognize any possibility that some of the growth in competitive IXC traffic (and, therefore, access minutes) that have occurred in the past may not continue because Verizon's own toll rates have become more competitive. Finally, Dr. Kahn ignored the possibility that as facility-based CLECs gain customers, some access service that Verizon presently provides will be diverted to those CLECs. (Verizon may, however, receive revenue from providing unbundled network elements (UNEs) to those CLECs.)

We also find that Verizon's estimate of $14.5 million access revenue loss is somewhat overstated. While the growth in access minutes is not likely to be as great as Dr. Kahn's estimate, it will not be zero. Some growth in interexchange carrier minutes is likely to continue. We find that it is reasonable to expect a moderate growth in access minutes and therefore find that Verizon is likely to incur an annual access revenue loss of $12.5 million.

We must decide whether we should allow Verizon to recover the $12.5 million access revenue loss through an increase to some other rates, and, if so, the method of that recovery.

We decide that we should permit that recovery in part because the access charge reduction is required by law, and in part because of our decision, in Part V, that we will not allow direct recovery, through immediate rate increases for basic services, for toll revenue losses. In Part V, we find that Verizon should be able to meet the need to lower toll to meet competitive pressures through increases in productivity and increased revenues for other services. It is not reasonable, however, to expect that Verizon should also be able to absorb the access revenue reduction of up to $12.5 million.

In the revised AFOR we do not continue the PRI that was part of the initial AFOR and its formal method of adjusting rates to compensate for significant "exogenous" changes in costs or revenues. Nevertheless, Verizon has presented reasonable arguments that the access charge reduction mandated by statute is in the nature of an "exogenous" change to revenues as defined by the first AFOR Order, as amended by the Stipulation approved in 1998 (also in Docket No. 94-123) that addressed the first round of access charge reductions required by 35-A M.R.S.A. § 7101-B. As discussed in more detail in Part V below, under the revised AFOR we will continue the same definition of exogenous changes in costs and revenues that we applied during the first phase of the AFOR.

The access revenue loss directly attributable to the operation of the statute is beyond Verizon's control and is unique to the telephone industry; it has a "substantial and disproportionate" effect on its revenues. Because we will not allow Verizon to recover retail toll revenue losses through increases to price-capped rates, we find it reasonable to allow it to recover the estimated access revenue loss of $12.5 million.

We note that under the operation of the PRI and the pricing rules of the initial five years of the AFOR, Verizon could have recovered some of the lost access revenues even without the characterization of that loss as "exogenous." Under the PRI, if Verizon reduced rates for whatever reason, it was allowed to increase rates (within the core discretionary category) to make up for the reduction, provided that its overall rate level remained within the limit established by the PRI. A similar ability will continue under the revised AFOR because Verizon will have pricing flexibility for most services. However, there may be occasions when Verizon or any other party believes that a cost or revenue change should be considered exogenous and should be recovered from or serve to reduce other rates. In that event, the party will need to seek a ruling from the Commission.

Verizon's witness Dinan proposed two methods for recovery of the access revenue loss:

(1) Increases in basic service rates;
(2) Implementation by Verizon of a Carrier Market Share Charge (CMSC) that would apply to interexchange carriers.

The access parity statute, 35-A M.R.S.A. § 7101-B, requires access rates that are equal to or less than federal access charge. It also states that the Commission must establish (and reestablish every two years) intrastate access rates that are less than or equal to interstate rates "notwithstanding any other provision of law."[3] Prior to

[3]In addition, Section 7101-B requires a setting of access charges without reference to the costs of providing access service.

the enactment of section 7101-B, we had construed the "basic rates that are as low as possible" provision of 35-A M.R.S.A. § 7303(2) as a rate design directive.

However, the "notwithstanding" clause of section 7101-B is intended to override other provisions of law, such as section 7303(2), to the extent there is a conflict between competing policy goals. We have found that the access rate reductions are exogenous and that recovery through other rates is appropriate. We also cannot read section 7101-B to require access rate reductions "notwithstanding" the constitutional prohibition against confiscation. It is the obligation of agencies and courts to construe statutes in such a way that they are constitutional. It is not practical to raise retail toll rates because of competitive market pressures that will tend to lower prices in the retail toll market. In addition, a provision of the access parity statute itself requires the Commission to require retail toll rate reductions if it finds that a competitive toll market does not exist.[4] Thus, "notwithstanding" the "lowest possible" language of section 7303(2), we find it is necessary to raise basic rates to address the revenue losses due to the access reduction. The resulting increased rates are as low as "possible" under the circumstances.

We decline to adopt the Carrier Market Share Charge (CMSC) proposed by Verizon or the universal service fund proposed by the Examiner's Report, to recover the $12.5 million. Verizon proposed that the CMSC would recover lost access revenue through an assessment on interexchange carriers (IXCs), based on each carrier's share of the total number of access minutes. AT&T and the Public Advocate argued that the CMSC proposed by Verizon would be unlawful, on the ground that the charge would be a thinly disguised access charge or access charge surcharge, with the result that Verizon's access charges effectively would exceed the level required by section 7101-B.

In addition to the legal question regarding the CMSC plan, we are concerned that a USF adds another level of governmental involvement and complexity as well as administrative costs that are likely to be high compared to the $12.5M size of the fund. A USF would also require a rulemaking that would take at least two months to complete and the need to hire an administrator. *See* 35-A M.R.S.A. § 7104 (3). Finally, while a USF would serve the purpose of spreading the access loss among a larger base of telecommunications users, Verizon customers would probably pay a considerable portion of the costs of the fund.

[4]Subsection 3 of section 7101-B states:

> If the commission finds that effective competition in the intrastate interexchange market does not exist, the commission shall require all persons providing intrastate interexchange service to reduce their intrastate long-distance rates to reflect net reductions in intrastate access rates ordered by the commission pursuant to subsection 2.

On balance, we believe that it is preferable to recover the $12.5 million in lost access revenues through an increase to basic rates. The first access rate reduction in May of 1999 was substantially larger than the present reduction. To recover that revenue loss, we approved a stipulated basic rate increase of $3.50 a month. Despite that increase, subscriber penetration rates actually increased. In this case we find that an increase of $1.78 a month is sufficient to recover the $12.5 million. The increase will apply to all access lines, including business lines. Business customers are likely to see substantial benefit from the reduction of access rates and therefore should absorb some of the access revenue loss. We will exempt Lifeline customers from any increase to minimize any possible losses in subscribership caused by the increase.

The Public Advocate has presented two other arguments against increasing basic rates that we find necessary to address in this Order.

First, the Public Advocate stated in its exceptions that it “objects to the incorporation of the May 2001 access change into this proceeding,” stating that “this proceeding was never formally noticed as a vehicle for consideration of that issue” and that “while the Public Advocate provided some testimony concerning that issue, he was not on notice that this would be the only opportunity to rebut the Company’s assertions concerning its projected access revenue losses.” We find that the Public Advocate did receive adequate notice that this issue would be addressed. The Notice of Investigation (December 27, 1999) in this case was sent to the Public Advocate. Part III of the Notice stated that “several events that occurred after the adoption of the [initial] AFOR …may need to be considered in deciding its future.” One of the four listed events was “Access Rate Reductions” that were required by 35-A M.R.S.A. § 7101-B. The description of this event included the process, during the initial phase of the AFOR, by which basic rates were raised. In addition, the second Part III of the Notice (there are two Part IIIs), entitled “Issues To Be Considered,” listed “pricing rules” among those issues.

The Further Notice of Inquiry (FNOI) in this proceeding, issued on June 26, 2000, provided substantial additional notice that the basic service rates would be an issue in the case. The FNOI proposed to cap basic rates at their present level and effectively to incorporate the access rate reductions required by law as a feature of the AFOR:

> The proposed AFOR will cap basic rates for the duration of the plan, and it will require BA-ME to reduce its access rates according to the provisions of 35-A M.R.S.A. §7101-B. We also expect that the access rate reduction will lead to lower in-state toll rates, and thus, we are effectively ordering a rate reduction for the Company that it cannot recover through increased basic rates.

This proposal surely would permit a party to argue for alternative approaches to the issue of basic rate levels and, in particular, whether a combination of access rate reductions and capped basic rates was appropriate. Part VI of the FNOI (entitled “Pricing Rules”), also tied these two issues together:

> Although not an AFOR pricing rule, we must, of course, continue to enforce the provisions of §7101-B by requiring that intrastate access rates remain equal to or less than the interstate access rates at the dates specified in the statute. Basic rates will be capped at their present levels for the term of the AFOR… .

Throughout this case, both parties have advocated different approaches to the issue of appropriate basic rate levels. The Public Advocate has argued that a price cap formula (such as the PRI in effect during the first five years of the AFOR) should remain in effect and that Verizon should be required to *reduce* basic local rates consistent with changes in the PRI. Since at least the filing of its prefiled testimony on January 8, 2001, Verizon has argued that the access rate reduction required for May 30, 2001 should be offset in part by a basic rate increase.

We find that the Public Advocate received adequate notice that this proceeding would consider the issue of basic rate levels in conjunction with the access rate reductions required by statute.

The Public Advocate also claims that we should not permit Verizon any recovery of revenues it may lose as a result of the access rate reductions because Verizon was involved in causing the need for those reductions. In a recent proceeding before the FCC, Verizon, as a member of the Coalition for Affordable Local and Long Distance Services (CALLS), advocated interstate access reform that included a substantial reduction in interstate access rates. The FCC adopted the CALLS proposal in modified form following input from a broad range of parties.

Under 35-A M.R.S.A. § 7101-B, a carrier's intrastate access rates may be no higher than its interstate rates. The reduction in Maine's intrastate access rates is due to the direct mandate of that statute and to the FCC's action in reducing interstate access rates. Verizon's role is indirect. Certainly, within the meaning of the definition of exogenous changes in revenues, it is a change that was not within its control.

Verizon undoubtedly has the right (as has this Commission and the Public Advocate), to advocate in a federal forum, what it believes is in its overall best interest, even though the result it advocates may result in effects elsewhere that others find undesirable. We reject the suggestion that Verizon should be precluded from any recovery of access revenue loss because of its role in the federal proceeding. We also note that in the federal proceeding the FCC ordered an increase to the Subscriber Line Charge (SLC) that is paid by end users. That charge is in effect a basic service rate component of interstate rates.

Finally, we address an issue raised by Verizon in its exceptions that the Examiner's Report failed to address, namely, whether and how Verizon should be allowed to recover for further access rate reductions (approximately $2-3 million) that

Verizon will have to make in May of 2003. This additional reduction is caused by the operation of the CALLS plan, which phases down the per-minute access rates. We will not decide at this time whether these access rate reductions, which are considerably smaller than the 2001 reductions, should constitute an exogenous change and should require an increase to basic rates. Like the 2001 reductions, they are required by law, but their size may raise questions about whether they should be considered exogenous and subject to a pass-through in rates. We leave to Verizon to decide whether it should seek to justify, under the rules of the revised AFOR, any changes to basic rates based on the 2003 access reductions.

V. TOLL REVENUE LOSS

As discussed above, Verizon should recover, through an increase in basic rates, the revenue loss for the known and immediate (May 30, 2001) reduction it must make in access charge rates. The access rate reductions are a direct and unavoidable consequence of the operation of the access parity statute, 35-A M.R.S.A. § 7101-B. By contrast, the access parity statute only indirectly affects retail toll rates and revenues; other factors also have an influence. It is likely that Verizon will have to reduce retail toll *rates*, although access charge changes probably are not the only influence on intrastate toll rates. Verizon's retail toll *revenues* may also decline, although changes (positive or negative) in Verizon's retail toll market share could have as substantial an influence on its retail toll revenues as the access rate reductions. The ultimate level of Verizon's retail toll rate and revenue reductions will be the result of many factors, including the fact the Verizon has some control over their magnitude through pricing strategy, marketing and retention or increases in market share. The reductions also will not occur immediately, and their amounts are far from certain.

We find that Verizon will be able to absorb the toll revenue losses through productivity gains, even though we do not implement a PRI or apply a productivity factor to any service, and through increases in revenues from other services.

Verizon has demonstrated under the present AFOR that it has been able to absorb rate reductions each year of approximately $7.5 million. Over the 5-year span of the initial phase of the AFOR, rates have been reduced by $38 million, or by 12.50%, as shown by the change in the price regulatory index (PRI) (the price cap) from 100 to 87.51 and the change in the actual price index (API) from 100 to 87.50.

Notwithstanding the *rate* reductions that Verizon absorbed during the present AFOR, Verizon's intrastate *revenues* during the 5-year span have increased by about $45 million, i.e., from about $321 million to about $366 million. Under the revised AFOR, the revenues within the former "core nondiscretionary" category may decline because access and retail toll constitute such a large proportion of that category, and Verizon will not be able to increase basic service rates beyond the $1.78 monthly amount that we allow in this order. However, there is no reason to believe that revenues for the former core discretionary and non-core categories will not continue to increase. In particular, because of strong customer demand, a substantial potential exists for increased revenues from high-speed data services.

We also observe that the nature of productivity gains is cumulative. If a utility achieves a gain in efficiency of $ X in one year and an additional $ X in the next, the total cost savings in the second year is $ 2X. By contrast, the loss of retail toll revenue that may result from a one-time decrease in access charges occurs once, even though the change is likely to be permanent. (It may take more than one year for the full amount of the reduction to be realized, however.) Thus, even though the projected (or finally realized) amount of toll revenue loss is larger than a single year's productivity gain, the cumulative nature of productivity gains is likely to overcome the one-time nature of a toll revenue loss reasonably quickly. We recognize that there may still be a timing difference between a substantial reduction in retail toll revenues (particularly if the toll revenue loss occurs very quickly) and Verizon's ability to absorb those losses through productivity gains and increases to other revenues.

Verizon has argued that both the access reductions and retail toll revenue reduction are "exogenous." We note that under the first phase of the AFOR, an "exogenous" change in costs or revenues is strictly defined and used as a factor in the price cap formula (the PRI). If an exogenous change occurs, it directly affects the allowed level of core rates. The revised AFOR will not recognize an "exogenous" change in costs or revenues in a formula that determines a maximum overall level of rates. Nevertheless, under the revised AFOR, we will allow exogenous changes to be recognized in rates when it is appropriate to do so, and we will use the same definition for exogenous changes in costs or revenues that we used in the first five years of the AFOR.[5] In applying that definition to the question of retail toll revenue changes, we cannot agree that they are "exogenous." The definition requires that an exogenous change be outside the control of Verizon. Verizon clearly has considerable (though obviously, in light of market forces, not unlimited) control over its retail toll revenues, and, even though the access parity statute may also indirectly influence their ultimate level, it will not be possible to identify the extent of any single influence.

For the revised AFOR we do not establish a formal pricing index or productivity factor. We also do not make a specific finding that productivity will occur at any particular level. However, we do find that Verizon will be able to absorb rate reductions of approximately the same magnitude as under the present AFOR because of continued productivity gains and increased revenues for services other than basic, toll and access.

The evidence in this case does not persuade us that productivity is likely to be substantially higher or lower than we found (and incorporated in the PRI) in the present

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[5]The definition in the original AFOR Order in Docket No. 94-123 (May 15, 1995) was restricted to changes in costs. In a subsequent Order issued on March 17, 1998 in the same docket, we approved a Stipulation that modified the definition to include changes in revenues, provided that the events that cause revenue changes "satisfy the conditions for exogenous treatment set forth in the AFOR Order."

AFOR. Two witnesses presented evidence that addressed the appropriate level of a productivity factor. Dr. William Taylor provided testimony for Verizon and Dr. Marvin Kahn provided testimony for the OPA. Dr. Taylor proposed a productivity factor of 2.0% and Dr Kahn proposed a 6.5% productivity factor including a "stretch" factor. We use the analysis provided by both witnesses to establish a plausible productivity range that serves as a check on the reasonableness of our finding that productivity gains should offset the toll losses that Verizon claims will occur.

Both witnesses addressed the productivity of the telecommunications industry in general rather than that of Verizon Maine. In the first AFOR Order we found that national productivity data is not necessarily relevant to Maine. Both witnesses failed to consider the impact of the cost savings due to Verizon's two recent mergers.[6] They also failed to account for the possibility that the impact of new technologies on Maine's cost structure is likely to be different from that of the nation as a whole. Neither analysis addresses the impact of the write down of Verizon's books that the FCC established as a condition of accepting the proposal put forth by the Coalition for Affordable Local and Long Distance Services (CALLS) for interstate access reform. Finally, both of the productivity analyses address the productivity of the industry as whole and not limited groups of services such as those designated as core services under the first five years of the AFOR.

We find Verizon's witness Dr. Taylor's proposed productivity factor of 2.0 % is understated for many of the same reasons that we stated in the proceeding (Docket No. 94-123) that established the initial phase of the AFOR. Dr. Taylor's analysis and his proposed productivity factor are almost identical to that which he provided in the initial AFOR case.

Dr. Taylor used pre-divestiture total factor productivity (TFP) data that extends back to 1947 to justify his productivity recommendation. In the past two decades, the United States telecommunications industry has undergone some of the greatest technological, market, structural and operational changes in its history. Since the enactment of the 1996 TelAct and widespread use of the Internet, those changes have accelerated. The use of studies that substantially pre-date those events is likely to create results that are not representative of today's telecommunications environment.

For several reasons, we also believe that Dr. Kahn has overstated the productivity of the telecommunications industry. Dr. Kahn included local minutes in his calculation of output, even though increases in local minutes do not result in revenue increases in Maine because of Maine's flat-rated pricing for basic service. Dr. Kahn also adjusted an input price to account for the fact that inputs into the production of

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[6] National productivity studies will recognize some of the productivity gains due to mergers to the extent merging companies are included in the national data. However, since national data include some companies that did not merge, national studies are likely to understate productivity gains by merged companies.

telephone service are likely to be different from inputs to the economy as a whole. He used the average of several years' data to make the adjustment. It is not clear that this adjustment is appropriate when the year-by-year input prices are so volatile. With that volatility, an average is unlikely to reflect any particular input difference. Finally, it is not appropriate to include a "stretch factor" in productivity estimates for a continuing AFOR. A "stretch factor" is designed to account for the increased productivity caused by the initial conversion to incentive regulation.

Set against the high probability that Verizon will be able to achieve continuing productivity gains, and the likelihood that those gains lie between the 2% estimated by Dr. Taylor and the 6% estimated by Dr. Kahn, is the equally high probability that Verizon's toll revenues will decline. Verizon has provided estimates of possible retail toll revenue losses. The estimates have a broad range of $19.8 million to $51 million. The very size of the range indicates substantial uncertainty. Because we expect that continued productivity gains and revenue increases from other services can absorb much of this loss, because the total amount (and the portion attributable to the access parity statute) are so uncertain, and because of other reasons explained below, the revised AFOR will not include any specific additional direct compensation to Verizon for retail toll revenue loss.

As noted above, it is likely that there is a link, albeit indirect, between wholesale access charges and rates in the competitive retail toll market. As access charges are reduced, retail toll rates offered by Verizon's competitors are also likely to decline. In a competitive market, prices tend to follow costs. When the costs for Verizon's competitors fall (as they will when access charges are reduced), those competitors will be able to and likely will reduce their retail toll rates. As one of the competitors in the market, Verizon may have to reduce its rates to meet those of its competitors. After the first round of access reductions that occurred following the 1999 enactment of the access parity statute, the Maine retail toll rates of both Verizon's competitors and of Verizon itself declined. Other competitive circumstances may also influence retail toll rates, however, including the fact that the intrastate toll markets in the various states are linked to the national interstate market through various interstate-intrastate optional calling plans offered by national Interexchange Carriers (IXCs).

If Verizon's retail toll competitors lower their rates, Verizon almost inevitably must lower its rates or risk loss of market share. Nevertheless, Verizon must make strategic pricing decisions based on its informed perception of all competitive markets in which it operates. Particularly under an AFOR, it has every incentive to establish prices that will maximize profits. In the revised AFOR, we are granting Verizon pricing flexibility for almost all non-basic services, including retail toll. Under an AFOR, Verizon should bear the risk of those pricing decisions, just as it will reap the benefits. It may succeed in optimizing profits or it may fail to do so because it misgauges competitive markets. Verizon should not be permitted to make up the difference between optimized revenues and unoptimized revenue levels through an increase to the limited number of rates that remain subject to regulation or through an increase in universal service funding.

It will be impossible, of course, to determine what portion of Verizon's ultimate retail toll revenue loss may be fairly attributed to any effect of the access parity statute, which is out of Verizon's control, and what portion is attributable to pricing decisions and marketing, which are within its control. Accordingly, it is difficult to justify a decision that Verizon should recover some specified portion of the toll revenue loss that may occur in the next few years.

Changes in market share are likely to affect retail toll revenues , either positively or negatively. We see no link, however, even an indirect one, between the access rates (required by statute) that may affect competitive retail toll rates and Verizon's retail toll market share. Retail toll market share can, of course, significantly effect retail toll revenues. The success that Verizon may or may not have in retaining (or even regaining) retail customers might significantly affect its revenues. Through strategic pricing decisions and marketing, Verizon has considerable influence over its share of the retail market. Access costs may affect overall rates in the intrastate retail market, but once that influence has been established, each competitor's market share is established by its own pricing decisions (relative to other prices in the market), brand recognition and other marketing efforts.

We recognize that much of what we say concerning market share of retail toll also applies to access, though inversely: assuming that total intrastate toll usage remains constant, gains by Verizon in toll mean losses in access and vice versa. Thus it is impossible, in advance, to estimate how much revenue Verizon will lose as a result of the access reduction when the toll effects are taken into account. Taking the evidence as a whole, however, we conclude that the access reduction will produce a revenue loss of at least $12.5 million (which we have allowed Verizon to recover through higher basic rates), and that the additional profits that Verizon will lose due to falling toll prices (and/or a smaller share of the toll market) will be matched – not exactly but conceptually within the AFOR framework – by increased productivity and other sources of revenue. We thus decline to provide a safety net to Verizon for every dollar that it lose from retail toll.

As discussed above, the amount of ultimate retail toll revenue loss is quite speculative at this point; the timing is also in doubt. We do believe, however, that there should be some guarantee that there is in fact a reduction in retail toll revenues and/or rates, i.e., that access rate reductions are flowed through to retail toll customers, particularly since retail customers will be paying for the access rate reductions through an increase to their basic rates. We will require Verizon to prove that retail customers receive the benefit of the access reductions by at least the amount represented by the low end of Verizon's estimated toll revenue loss. That amount is $19.8 million.[7]

[7]The Part One Order in this case (May 9, 2001) mistakenly stated that Verizon's low estimate was $19 million.

Wholly apart from the obligation we have to demonstrate to consumers that, on balance, the increases to basic rates will be accompanied by reductions in rates consumers pay for toll services, our requirement that Verizon show that consumers have benefited in fact (and not just theory) by $19.8 million is warranted to ensure the integrity of our process. Verizon claimed that it would lose *at least* $19.8 million annually in toll revenues as a result of the access reduction. We have relied on that representation both in allowing Verizon to increase basic rates to recover 100% of the expected *access* lost revenue, and in declining to impose a specific productivity offset that would be likely, in periods of low inflation, to force specific *decreases* in Verizon's rates. If Verizon's estimate is correct, and toll revenues or rates will fall *at least* $19.8 million, Verizon will have no difficulty meeting the condition we impose here. If, on the other hand, Verizon's estimate was merely a litigation posture, and it does not "really" expect that reduction, Verizon cannot now complain that the Commission has taken it at its word; it should bear the financial consequences of its litigation strategy.

The Company may comply with this requirement by showing that either its retail toll revenues or its retail toll rates have declined by at least $19.8 million. If Verizon decides to show that its toll revenues have declined, it shall use the 12 months that ended on May 31, 2001 as the base period. The Company must show that its actual recorded retail toll revenues for the 12-month period ending on May 31, 2003 are lower than those in the base period by $19.8 million. We allow Verizon to use the second full year following the implementation of the revised AFOR (and the access rate reductions that went into effect on May 30, 2001) so that access rate and any toll rate reductions will have their full effect on toll revenues. Verizon must compare its total intrastate toll revenues for the base period to the future period to show that its actual recorded revenue declined by at least $19.8 million.

If the Company decides to make the required showing that its retail toll rates have declined by $19.8 million it shall compare the rates that are in effect on May 31, 2002 with those that are in effect on May 31, 2001. For the purpose of weighting the rates in effect at those two points in time, the Company shall use billing units for the 12 months ending May 31, 2001. This method is essentially the same as that used during the first five years of the AFOR for establishing that proposed rate changes satisfied rate change requirements under the PRI formula. This rate comparison alternative allows Verizon to disregard its actual toll revenue level and concentrate on increasing or retaining its toll revenue through pricing decisions and marketing that might result in increases in sales volumes (billing units) or in market share.

Verizon must make a filing by July 31, 2003 that demonstrates that it has met one of the two alternatives. If it chooses the rate reduction option, it must show that its retail toll rates in effect on May 31, 2002 were $19.8 million lower than those in effect on May 31, 2001. If Verizon chooses the revenue option, it must make a filing showing that its revenues for the period June 1, 2002 to May 31, 2003 were at least $19.8 million less than its retail toll revenues for the period June 1, 2000 to May 31, 2001. If Verizon has not achieved a retail toll revenue reduction of at least $19.8 million by May 31, 2003, it must file rate reductions (for toll or other services) that will have the effect of reducing revenues by the amount of the difference between $19.8 million and the actual achieved amount of revenue reduction, based on the billing units for the 12-month period ending May 31, 2001.[8]

One of the central characteristics of incentive regulation is that a utility bears the impact of high and low earnings due to a variety of causes, including competitive market forces. In the first AFOR Order, we rejected arguments that we should impose caps on over-earnings and under-earnings. In the revised AFOR, Verizon will have a substantially greater amount of pricing flexibility than it had during the first five years of the AFOR. We expect that Verizon will bear the risks and reap the rewards of the market. Our finding and decision that Verizon should be able to absorb reductions in toll revenue through productivity gains provides a considerable incentive for Verizon to undertake every reasonable effort to produce such productivity gains. Verizon should not expect during the AFOR to request “relief “ for toll revenue losses that exceed its estimates. Any such action would be antithetical to an AFOR incentive plan.

VI. OPERATOR SERVICES AND DIRECTORY ASSISTANCE

In the FNOI, we suggested that the markets for directory assistance (DA) and operator services were not sufficiently competitive to allow Verizon pricing flexibility for its provision of these services. Verizon has argued that those markets are competitive and that we should allow pricing flexibility. We decide that the services will remain subject to direct price regulation.

Operator services are services that require the assistance of a live operator, or a mechanized equivalent, that obtains billing data from the caller when a call is not or cannot be billed to the line used for originating the call. The most familiar mechanized equivalent is the “bong tone” that signals to a caller to enter a calling card number. Other types of calls that require operator assistance include calls billed to a third party and collect calls.

Directory assistance provides phone numbers to callers who do not have access to printed or electronic directories, who are unable or unwilling to use an accessible directory, or who request numbers for new listings not included in any directory.

These services are offered by both local exchange carriers and interexchange carriers. Verizon provides both local and interexchange telephone service and is a major provider of both directory and operator services. The other major providers of directory and operator services are interexchange carriers such as AT&T, MCI WorldCom and Sprint. Operator services are used almost exclusively in connection with long-distance (toll) calls. Directory assistance is provided in conjunction with both

[8]We recognize that there may be ways to try to game this alternative, but we trust that Verizon will act in good faith. Needless to say, if the Commission found a rate reduction only technically complied with this condition, but otherwise did not meet its spirit, it would find it was not in compliance with this Order.

local and long-distance services. Most callers have access to local directories, but the telephone numbers of new customers who move into a local calling area will not be included until the directory is republished. Callers generally have less access to directories for locations outside their local calling areas.

The providers of DA and operator services charge a fee for each use of the services. Those fees are in addition to any toll or other charge that applies to the call that the caller makes in conjunction with using the service.

Little evidence has been presented about this issue. Verizon's evidence and argument consist of conclusory statements that there are multiple providers of operator and directory assistance services, including the availability of some directory assistance information on the Internet. Verizon has not shown that there is price competition for these services. The Public Advocate provided no evidence or argument on these issues beyond the argument that a core nondiscretionary category (presumably including operator services and DA) should still exist and be price-capped.

During the five and a half years of the current AFOR, Verizon's rates for directory assistance and operator services have remained capped at the levels that existed immediately prior to the AFOR. In the Order establishing the first AFOR, we found, without extensive discussion, that these rates were "core nondiscretionary," meaning that we considered them to be "essential" rather than "nonessential" services and that they could not be increased unless the PRI (the overall price cap) was positive.[9] In many cases it is not possible to make a phone call without using an operator service and/or DA. In this sense, DA and operator service calls are more "integral" to basic service than other "optional" services; customers using these services may legitimately expect a greater degree of regulatory price oversight until robust price competition emerges.

Nothing has changed during the course of the AFOR that makes these services any less essential. Although there may be more DA providers than previously, there is some concern that their listings are incomplete and inaccurate.[10] In this proceeding, Verizon has made no claim that either of the services is priced below cost. Indeed, the increasing mechanization of these services indicates that costs might be declining.

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[9]The PRI was negative in all five years of the AFOR.

[10]The FCC, in CC Docket No. 99-273 (January 27, 2001), has required ILECs to make their DA databases available to competitors (including both IXCs and Internet DA providers) at nondiscrimatory and reasonable rates because of concerns about the accuracy of competitors' databases and because ILECs derive their more accurate databases from their service ordering processes. The FCC's purpose in ordering this access was to promote a competitive market for DA services. It found that competing providers have had difficulty offering a competitive product.

We take notice (through rates on file with the Commission) of the fact that virtually all of Verizon's "competitors" for operator and directory assistance services charge substantially more than Verizon. For example, Verizon's surcharge for using a calling card is 58 cents. Although some subscribers to long distance calling plans offered by AT&T, MCI WorldCom and Sprint may receive somewhat lower charges, calling card charges for other users are from $2.25 for MCI to $3.95 for Sprint.[11] In addition, those carriers appear to charge higher per-minute toll rates for operator-assisted calls than for 1+ calls.

For collect calls, the surcharges of AT&T, MCI WorldCom, and Sprint range from $2.25 to $3.95. Verizon's surcharge for a collect call is $1.30.

For directory assistance, the charges imposed by AT&T, MCI WorldCom, and Sprint for casual users range from $.80 to $.95. Verizon's charge is 40 cents for each request (after an allowance of three free requests per month).[12]

During the initial phase of the AFOR, all three of these competitive interexchange carriers have consistently raised their operator service and directory assistance rates.

Although there are other suppliers of these services, it appears that there is no *effective* price competition. As of 1999, Verizon's market share (based on revenues) of the Maine intrastate retail toll market was about 55%. As noted above, operator services are used primarily in conjunction with toll calling and DA is used in conjunction with both local and toll calling. Verizon provides the vast majority of local exchange service within its service territory, and given its large shares of both the toll and local exchange markets, one might expect that Verizon would be a price leader in associated markets, and that other providers would attempt to compete with Verizon's prices. In fact, as discussed above, other providers continue to have substantially higher charges than Verizon's and continue to increase those changes.

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[11]AT&T charges a $2.25 rate for callers who use a non-AT&T calling card, but $1.25 to callers who use a calling card issued by AT&T. However, if a caller accesses AT&T's network by means other than by 10+10+288 or 1-800-CALLATT and uses a card issued by a carrier other than AT&T, the surcharge is $4.95.

[12]The Commission required 10 free requests in *New England Telephone and Telegraph Company, Re: Proposed Increase in Rates,* F.C. #2213, Order (June 10, 1977). Prior to that case, New England Telephone had provided directory assistance without charge. The Company argued that a small number of customers made most of the directory assistance calls and that about half of DA calls were made for numbers that were published in the caller's local directory. The Company proposed a charge to deter excessive use of the system and to recover its costs from those who used the system. The Commission required the Company upon request to provide free directories for any location within 30 miles of the customer's home exchange. Subsequent cases gradually reduced the free call allowance to three.

The manner in which customers purchase DA and operator services contributes to our conclusion that we should not yet remove price constraints. Telephone callers can reach carriers other than the one to which the line is presubscribed through "dial-around" (using a 101XXXX code, a 950XXXX number, or an 800 number). Nevertheless, a caller who attempts to place a 0+ call (to use a calling card or to place another type of call requiring an operator service) without "dialing around" will obtain the operator service from the company to which the telephone line (including a pay phone) is presubscribed.

In contrast to operator services, a customer who calls DA service will obtain the DA service provided by the customer's local exchange carrier. In Maine, that service will be provided by Verizon (whether the customer calls 411, 555-1212 or 1-207-555-1212), unless the customer has subscribed to a competitive local exchange carrier (CLEC) or "dials around" to reach a DA service provided by an interexchange carrier using the carrier's 101XXXX code, 950XXXX, or 800 number, then dialing Area Code + 555-1212. (In most cases, the caller must also dial a billing number, (e.g., a calling card). A caller may obtain Verizon DA by dialing 411; from a line that is prescribed to another carrier, calling 411 is a form of dial-around.

Because of the difficulty of dialing around, we doubt that most consumers will dial around for alternative DA and operator services, even if they knew the prices of alternative providers. Some carriers effectively discourage shopping around by callers that do not have a calling card issued by that carrier. As noted above, AT&T charges $2.25 for using a non-AT&T calling card while it charges $1.25 per charge for a customer that does use an AT&T card.

Because of the extremely small penetration levels by CLECs, almost all persons who call DA service will obtain the service provided by Verizon unless they go through the cumbersome dial around process. At present, at least in part because of regulation of intrastate DA rates, dialing around has no benefit. Verizon DA users will obtain much more favorable rates by not dialing around. The fact that Verizon has a virtual monopoly on DA service (even if it presently acts as a benevolent monopolist) is nevertheless a strong reason for continued regulation.

We place little weight on Verizon's claim that the Internet offers alternative DA services. Not everybody is connected to the Internet. Moreover, the FCC has expressed concerns about the accuracy of DA information from IXC and Internet providers. Persons who are traveling constitute a substantial portion of users of DA services; those persons are far less likely to have access to the Internet than persons who are at their home or workplace, particularly when they are at a pay phone. It is doubtful that the Internet offers any operator services because, at present, persons who use the Internet to make long-distance calls do so for "free," i.e., without per-minute charges.

We find that DA and operator services are essential, at least for the completion of many calls, and that effective price competition for these services has not yet emerged.

We will therefore not allow Verizon to establish prices without direct regulatory oversight. Verizon's prices for these services will be capped, unless, during the course of the AFOR, it makes a showing that increases or pricing freedom should be allowed. We recognize that the prices for these services have been in effect now for more than five and a half years. If Verizon proposes to change any of these prices, however, it will need to prove that its proposed price changes are cost-justified. We will also consider a request to allow greater pricing flexibility if Verizon can show that a truly competitive market has developed for either of these services.

VII. SERVICE QUALITY

A. Introduction

The Commission included a Service Quality Index (SQI) in the first phase of the AFOR with performance baselines and financial penalties, first to meet our service quality goals for telecommunications,[13] and second to provide Verizon Maine (then NYNEX) with strong financial incentives not to cut its costs at the expense of service quality. Because we believe the SQI has proven effective during the first five years of the AFOR, we continue the mechanism but adopt modifications to the SQI in the revised AFOR.

B. Positions of the Parties

1. Verizon Maine

Verizon Maine argues that a Service Quality Index (SQI) is unnecessary in a revised AFOR because Verizon Maine's service quality was good before the AFOR, it has been good during the AFOR, and it would have been good without the AFOR's SQI; and competition has increased under the AFOR, is bound to continue increasing as time goes on, and because service quality is an important feature as customers choose among competitive service providers, maintaining good service quality is critical to Verizon's success in the competitive marketplace.

Moreover, Verizon alleges, the terms of the Bell Atlantic-GTE merger are effective in ensuring quality. Under the merger terms, Verizon reports monthly service quality data for each state to the FCC in accordance with the criteria in the NARUC "Service Quality White Paper" (the reports are available from both the FCC and Verizon websites), and Verizon Maine has committed to the "Service Quality Assurance Plan," which includes better customer communication on installation appointments, better network monitoring and response to network congestion, an

[13] Those goals are to "ensure" that telecommunications service quality, reliability, customer treatment, and credit, collection, and sales practices (including possibly anti-competitive activities), receive adequate regulatory consideration and protection; and maintain adequate quality of service standards and reporting requirements so that achievement of goals can be evaluated." Docket No. 94-123 Notice at 4.

"ombudsman" position focused exclusively on Maine service issues, and quarterly meetings with the Commission and Staff to review service results.

Further, Verizon argues that in a competitive marketplace, the administrative and financial burden of imposing an SQI with a rebate mechanism *only* on Verizon Maine would be inequitable. If the Commission determines service quality reporting is necessary in a revised AFOR, the reporting should be based on industry-wide baseline performance levels and be required of all carriers.

Finally, Verizon maintains that the current SQI has proven successful in preventing "the systematic and wide-spread deterioration of service quality" feared by the Commission under incentive regulation. Therefore, if the Commission determines an SQI is necessary in the revised AFOR, it should continue the current SQI unchanged.

2. The Office of the Public Advocate

The OPA argues that an SQI is necessary in a revised AFOR because, although service quality is an important characteristic for choosing service providers in a competitive market, Verizon Maine has virtually no competition in the residential local exchange market. It further argues that Verizon Maine is such a small portion of the revenues from Verizon's 13-state footprint that the resources necessary to assure good service quality could disappear without an SQI.

The Public Advocate also claims that most competitors will not duplicate Verizon Maine's network but will rely on Verizon Maine's service quality to provide services to customers in Maine; thus, Verizon Maine's service quality will be critical even if a customer takes local exchange service from a CLEC, and that only Verizon Maine has the duties and obligations associated with its role as the incumbent provider of local exchange service for the vast majority of Maine's households and businesses; yet there are no specific service quality standards that are applicable to Verizon Maine except for those that exist in the SQI. Further, it argues that if the revised AFOR is, like the initial phase of the AFOR, a multi-year plan, there will be no regular rate cases to trigger service quality reviews and responses.

Finally, OPA argues that the data Verizon reports to the FCC pursuant to the NARUC Service Quality White Paper provides no performance baselines and therefore no basis for tracking comparative performance over time and no penalties or customer rebates for deterioration in performance.

The OPA would not oppose Verizon's position that the Commission should require service quality reporting not just by Verizon Maine but by all LECs and CLECs. Minimum service quality standards applicable to *all* carriers, however, would not necessarily reflect Verizon Maine's historical performance and might instead allow a lower level of performance by Verizon Maine, because of the tendency of generic rules to apply the "lowest common denominator" as the minimum performance standard.

Such generic service quality reporting would be no substitute for a SQI with performance baselines that reflect Verizon Maine's performance.

The OPA argues that the original SQI should be changed in the following areas: the baseline performance levels and how performance is measured, for some metrics; added performance metrics and baseline levels; and the rebate structure, to account for the number of proposed metrics and Verizon Maine's current revenues.[14]

C. Generic Topics Raised in the FNOI

1. General Description of Topics

The FNOI asked for comments on a number of generic topics discussed in connection with the proposed SQI: more "granular" reporting, such as by wire center; separate reporting for residential and business customers; separate reporting for urban and rural areas; using "surveillance" levels; how performance baselines should be set; how any customer rebate mechanism should be structured; and whether to include carrier-to-carrier wholesale service quality performance metrics. We discuss the parties' responses below.

2. SQI Reporting by Wire Center vs Service Territory-Wide

Both Verizon and the OPA expressed concerns about the burden, costs, complexity – and for Verizon also the necessity – of wire center-based reporting for the SQI. Verizon states that it lacks historical wire center data for many of the metrics in the SQI that was proposed in the FNOI, and that it would be an extremely cumbersome, time-consuming, and expensive manual effort to report wire center-based data for metrics for which historical data are available.

3. Separate Reporting for Residential and Business Customers

The OPA supports separate reporting for residential and business customers, claiming that historical data would show Verizon Maine performing at a higher level for business customers for most SQI metrics and that such gaps should be closed over time so as to provide residential customers the same quality of service it provides business customers. Verizon Maine states it has historical data for each customer class (from which baseline performance levels could be calculated) for several SQI metrics, but generally opposes expanding the SQI reporting beyond the levels in the current SQI. Verizon Maine points out that its reports to the FCC pursuant to the NARUC White Paper's service quality criteria include separate reporting for residential and business customers, and that the Commission will be able to monitor Verizon Maine's performance by customer class with those reports.

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[14]The OPA's proposed SQI is described below in Section VII. D.2.

4. Separate Reporting for Urban and Rural Areas

Verizon Maine's position on this issue is the same as its position on separate reporting for residential and business customers. The OPA did not comment on this issue.

5. Service Quality "Surveillance" Levels

NARUC's Model Telecommunications Service Rules include the concept of "surveillance" levels, which appear to be about 20% less stringent than the SQI baseline performance levels. Under these rules, if a carrier fails to meet a performance metric's surveillance level for three consecutive months, it must investigate, take corrective action, and report the results to the Commission. The FNOI asked whether some or all of a revised SQI's metrics should incorporate surveillance levels.

The OPA is opposed to using the surveillance levels' "two-tiered" approach; it argues that the lowest performance level would become the focus of attention and enforcement and, therefore, the only standard that has regulatory significance. Using a single standard – such as the SQI's baseline performance level – avoids confusion about the Commission's expectations and the public's understanding of what Verizon Maine must achieve to avoid paying customer rebates.

Verizon Maine is also opposed to an SQI that incorporates surveillance levels, because they would cause an additional, burdensome layer of administrative reporting and substitute lower thresholds for customer rebates than those set by the SQI's baseline performance levels. Verizon Maine stated that it could support surveillance levels if the Commission changed the SQI's reporting structure to "exception reporting" (i.e., reporting only service results that are worse than the defined performance level), whereby the Commission could require reporting of any SQI metric for which the monthly results fell below its surveillance level for three consecutive months. Verizon Maine suggests such an arrangement would reduce the administration burden of monthly service quality reporting for both itself and the Commission.

6. How SQI Baseline Performance Levels Should be Set

In the prior AFOR proceeding, we considered how to reflect the year-to-year variability in Verizon Maine's (then NYNEX's) performance, as measured by the SQI's metrics, in setting performance baselines. Ultimately we accounted for that variability by setting the SQI's performance baselines at Verizon Maine's worst annual performance in each of the three years prior to the AFOR order, i.e., 1992-1993 through 1994-1995.

For the SQI in the revised AFOR, Verizon Maine supports the method the Commission used: it states that the baselines were set so as to assure that service levels under the AFOR would not deteriorate below the levels achieved under rate of return regulation, that any revised SQI should be based on that same rationale, and therefore in a revised SQI no changes should be made to the original SQI's performance baselines. The OPA states that performance baselines should reflect Verizon Maine's historical performance and be based on a review of the degree of variability in it and any trends in recent performance.

7. How a Customer Rebate Mechanism Should be Structured

Verizon Maine states that in a competitive market, in which customers who are dissatisfied with a carrier's service quality will simply take their business elsewhere, the Commission must exercise caution when it imposes service quality standards and penalties on any single carrier. The market should be allowed to develop all conceivable service options if there is customer interest, without hindrance from Commission-imposed service reporting standards. If the Commission concludes that service quality reporting and penalties continue to be required to maintain service quality, Verizon Maine opposes any increases in penalties, or shifts in the distribution of penalties among SQI metrics, or changes in how rebates to customers are distributed, because such changes would only add to its overall administrative compliance costs, which ultimately must be borne by its subscribers.

The OPA recommends no change in the basic structure of the existing customer rebate mechanism. It recommends increasing the maximum rebate amount at risk to reflect Verizon Maine's current revenues, however, so as to provide the same incentive to Verizon's management not to cut costs at the expense of service quality in the second phase of the AFOR as the maximum rebate amount did in the initial phase. Otherwise, the OPA argues, Verizon Maine might conclude that the payment of penalty dollars is "worth" a certain amount of deterioration in service quality. The OPA recommends the maximum rebate amount be set at 4.5% of jurisdictional retail revenues.

8. Service Quality to CLECs: "Carrier-to-Carrier" Service Quality Performance Metrics

Because the development of local exchange competition was an important aspect of the AFOR revisions proposed in the FNOI, the Commission asked parties to comment on whether a revised SQI should incorporate metrics that measure the quality of Verizon Maine's services to CLECs. Verizon Maine recommends that the Commission not add such metrics to a revised SQI but instead develop them as part of its Section 271 proceeding that the Commission will conduct.[15] The OPA makes the same recommendation, and, in particular, recommends that the Commission use the same performance metrics the FCC imposed as a condition of its approval of the Bell Atlantic-GTE merger.

[15] Under 47 U.S.C. § 271 the Commission must "consult" with the Federal Communications Commission concerning whether Verizon should be permitted to provide interLATA service in Maine.

D. SQIs Recommended by the Parties

1. Verizon Maine's SQI Recommendations

Verizon Maine contends that Maine's telecommunications market has become competitive, that competition will increase, and that because service quality is such an important factor in choosing a service provider in a competitive market that competition will discipline carriers' service quality. The Commission therefore should allow the market, rather than an SQI's metrics, to determine which service characteristics customers care most about and carriers should therefore concentrate on. Thus, Verizon Maine contends an SQI is unnecessary. Verizon Maine further contends that in a competitive market any service quality reporting the Commission considers necessary should be imposed not just on Verizon Maine but also on all its competitors.

If the Commission decides an SQI continues to be necessary to maintain its service quality, Verizon Maine recommends that at most the Commission retain the current SQI, its performance baselines, customer rebate mechanism, and maximum and per-metric rebate amounts, unchanged.

The original SQI had 12 performance metrics. (See Table 1).

TABLE 1
Current Verizon Maine SQI

PERFORMANCE METRICS	BASELINES
<u>CUSTOMER SERVICE</u>	
Installation - % Appointments Not Met on Time – Co Reasons	1.65
Held Orders Average Total Delay Days	2051
Business Office calls % Answered over 20 seconds	31
<u>SERVICE RELIABILITY</u>	
Customer Trouble Reports Rate per 100 lines – Network	1.08
% Troubles not cleared within 24 hrs – Residence	21.1
% Troubles not cleared within 24 hrs – Business	9.0
Dial Tone Speed % over 3 seconds	0.36
Major Service Outage	977
<u>CUSTOMER SATISFACTION (% ALMOST MET/FAILED EXPECTATIONS)</u>	
TELSAM Residence Provisioning	7
TELSAM Small Business Provisioning	11
TELSAM Residence Maintenance	14
TELSAM Small Business Maintenance	15

2. OPA SQI Recommendations

The OPA proposes an SQI with 20 metrics grouped into the same three service categories as in the original SQI. It would include 10 new metrics and 10 metrics from the initial phase of the AFOR. Of the metrics from the original SQI, eight would be unchanged, and the performance baseline of two would change. The OPA's proposed SQI also includes two additional metrics without performance baselines, which the Commission could consider adding when sufficient historical data is available to calculate performance baselines. (See Table 2.)

TABLE 2

SQI PROPOSED BY THE OPA FOR VERISON-MAINE

PERFORMANCE METRIC	BASELINE
(N) = new metric	(C) = changed baseline
CUSTOMER SERVICE	
(1) Installation Appts. Not Met (Co. reasons)-Res.	1.65%
Repair Appts. Not Met (Co. reasons)-Res.	Report Only*
(2) Installation Orders Held-Res. And Bus.	
(N) Missed Installation Rate	.67
(N) Average Delay Days Installation Held Orders	6.14
(3) Answer Time Performance	
(C) Business Office: % Ans. >20 sec.	25%
(N) Repair Center Calls: % Ans. > 20 sec.	25%
(N) Repair Center Busy Rate	3%
RELIABILITY OF SERVICE	
(4) Percent Troubles Not Cleared w/I 24 hrs.-Bus.	21.1%
(5) Percent Troubles Not Cleared w/I 24 hrs.-Res.	9.0%
(6) Customer Trouble Report Rate per 100 lines	1.08
(7) Network Congestion	
(C) Dial Tone Speed: % over 3 sec.	.1%
(N) Host/remote clusters > .36% delay	0
(N) Umbilical Blockage, units >.11% blocking	Report Only*
(8) Service Reliability	
(N) Service Outage (5,000 lines > 30 min)	0
(N) Interoffice Fiber Failure (30,000 lines > 30 min)	0
(N) SS7 Failure (>30 min.)	1
<u>CUSTOMER SATISFACTION (% almost met/failed expectations)</u>	
(9) Provisioning	
CCI Residence Provisioning	7
CCI Sm. Bus. Provisioning	11
(10) Maintenance	
CCI Residence Maintenance	14
CCI Sm. Bus. Maintenance	15
(11) (N) PUC Complaint Ratio	0.6

* The OPA recommends the Commission evaluate this data after two years and then decide whether to add these performance areas to the SQI with a performance baseline that reflects Verizon Maine's performance. If these items are added, the OPA recommends appropriate changes be made to the penalty structure, including an increase in the total penalty dollars at risk.

3. New Metrics Proposed By OPA

a. Repair Appointments Not Met for Company Reasons

Verizon Maine's repair performance was measured in the original SQI by the "Troubles not cleared within 24" hours metrics for business and residential customers. The OPA points out, however, that the percentage of repair appointments missed for Company reasons is much higher than for installation appointments missed, averaging seven to eight times higher over the last three years.

b. Held Orders

The OPA proposes to replace the "Held Order" metric in the original SQI with two new metrics: "Missed Installation Rate" and "Average Delay Days Installation Held Orders." The first is the percentage of installation appointments missed for Company reasons; the second is the number of "delay days" between the promised installation appointment date and the date of the completed installation, averaged over all customers with orders delayed for Company reasons. The OPA believes these metrics do a better job than the original SQI metric in measuring the delays customers actually experience in waiting for basic service to be installed.

c. Answer Time Performance[16]

Repair Center Calls: percent answered in greater than 20 seconds, and Repair Center Busy Rate. This area of performance was not measured in the original SQI. The OPA believes customers deserve the same call answering performance for reporting service troubles as they get calling Verizon Maine's business office.

The OPA recommended a 25% call answering baseline, based on its assessment of Verizon Maine's recent performance. Its recommended 3% Busy Rate baseline is based on a standard included in a stipulation that Verizon-Vermont joined in Vermont and OPA's assessment of the rate in place at the federal level for calls to cable TV operators.

d. Network Congestion

Host/remote cluster – dial tone speed: percent over 3 seconds; and Umbilical Blockage. The OPA proposed the dial tone speed (DTS) metric be applied to each of Verizon Maine's 14 host/remote switch clusters. The OPA-

[16]The OPA appears to recommend that this metric and the Held Order metrics be reported separately for residential and business customers (which if so would make a total of 25 metrics in its proposed SQI). The Examiner's Report requested clarification from the OPA on these points, but none was provided in its exceptions.

recommended 0.36% baseline is the DTS baseline in the current SQI, which is the DTS averaged over all Verizon Maine's central office switching machines.

The Umbilical Blockage metric measures the percentage of calls blocked when all trunks are in use that connect remote switches to their host switches. The original SQI did not measure call blocking, which, along with delayed (or no) dial tone, occurs when a telephone network is congested.

e. Service Reliability

Service Outage (5,000 lines > 30 minutes); SS7 network failure (>30 minutes); and interoffice fiber failure (30,000 lines > 30 minutes). These outages were measured by the Service Outage metric in the original SQI, but the OPA believes it is inadequate, arguing that the present baseline is not a strict enough standard and thereby allows Verizon Maine's reliability to deteriorate without penalty. For these three new metrics, the OPA's recommended baselines (0; 0; and 1, respectively) and penalty amounts [$250,000; $250,000; $500,000 (> 30 minutes); $1,600,000 (> 60 minutes), respectively] are based on standards to which Verizon stipulated in Vermont.

f. PUC Complaint Ratio

This metric measures the number of complaints made by Verizon Maine's customers to the Commission's Consumer Assistance Division. The ratio is the number of complaints filed per 1,000 utility company customers. These are complaints that customers have already discussed with Verizon Maine, but its response did not satisfy the customers.

The OPA bases the inclusion of this metric on a recent surge in disconnection-related complaints that were attributed to Verizon-New England when Verizon consolidated some Verizon Maine-based customer service operations with operations in Massachusetts. The OPA's recommended baseline (0.6) is based on its assessment of 1997-1999 complaint statistics.

4. Changed OPA Metrics

Dial tone delay: percent over 3 seconds, and Business Office: percent of calls answered in over 20 seconds. The OPA-recommended baselines (0.1% for dial tone delay and 25% for call answering performance) are based on its assessments of Verizon Maine's recent performance.

5. Other OPA Service Quality Recommendations

a. Customer Rebate Dollar Amount

The OPA recommended the total dollars at risk in the SQI be raised to $16 million, from the current $11 million. This recommendation is based on Verizon Maine's current revenues and the fact that Verizon Maine is a much smaller part of a much bigger company.

b. Customer Notification of Service Quality

The OPA recommended the Commission continue the provision in the initial phase of the AFOR that requires Verizon Maine to inform customers that a service quality penalty has occurred. The OPA also recommended that the revised AFOR include an annual service quality report to be sent by Verizon Maine to its customers, so they will be informed of Verizon Maine's performance in all service quality areas the Commission is monitoring.

c. Customer Rebates for Specific Failures

The OPA points out Verizon Maine's tariffs provide rebates to customers when local service and other services are interrupted beyond specific lengths of time, but that customers must apply to Verizon Maine for the rebates and do so within ten days. The OPA recommends that the Commission end the application requirement and order Verizon Maine to make the rebates automatic and to periodically inform customers that such rebates exist.

d. Other OPA Recommendations

The OPA also recommends that the revised AFOR include rebates when Verizon Maine fails to keep appointments or fails to install service on the date promised. The OPA recommends the rebate be a fixed amount or a waiver of certain charges. In addition to requiring Verizon Maine to act like a company subject to competition, the OPA suggests such rebates will help ensure against localized service quality failures that would not show up in the SQI's service territory-wide averaging.

E. The Revised SQI

We will include a Service Quality Index in the revised AFOR for the same reasons we included the SQI in the current AFOR, and for the following additional reasons. First, under the structure and pricing rules of the revised AFOR, only Verizon Maine's rates for basic exchange service for residential and small business customers, directory assistance and operator services are capped; Verizon Maine has pricing flexibility for all other retail services. The revised AFOR therefore represents a substantial reduction in the regulation of Verizon Maine's operations compared to the current AFOR. Second, there is insufficient local exchange competition in Verizon

Maine's service territory – and virtually none for its residential and small business customers – for the Commission to rely on competition alone to cause Verizon Maine to maintain and improve its service quality. Third, as the OPA has pointed out in this proceeding, most CLECs in Maine rely in whole or in part on the quality of Verizon Maine's services and facilities to provide local exchange service to their customers. Fourth, we believe Verizon Maine, as a small fraction of its parent company, will need the monetary rebate mechanism of an SQI to command the attention of Verizon management.

We reject Verizon Maine's position that Maine's local exchange market is, or soon will be, competitive enough for customers dissatisfied with its service quality to simply take their business elsewhere. The testimonies of OPA witnesses Norton and Sweet establish that CLECs provide virtually no competitive alternatives for residential and small business customers.[17]

As we noted in the FNOI, Verizon Maine's service quality during the AFOR has generally been good. Verizon Maine may well be correct that its service quality also would have been good without the SQI and its rebate mechanism. We agree with Verizon Maine's position that, in a competitive market for local exchange service, competition should be sufficient to discipline the carriers' service quality, and we agree that in such a market all carriers, not just Verizon Maine, should be required to comply with any service quality reporting the Commission decides is necessary. But Maine does not yet have a competitive local exchange market; the record in this case shows that Verizon Maine dominates the market in its service territory. Thus, we agree with the OPA. For the foreseeable future, only Verizon Maine has and will have the duties and obligations associated with being the only provider of local exchange service for the vast majority of Maine's homes and businesses, and there are no specific service quality standards that are applicable to Verizon Maine – except those that exist in an SQI.

In the FNOI, we asked the parties to consider a number of refinements and additions to the current SQI, including separate reporting for urban and rural regions and for residential and business customers, and especially reporting certain metrics by wire center, rather than the service territory-wide reporting that is averaged over all 140 Verizon Maine wire centers. Averaging has a well-known "smoothing" effect, which can mask both extremely good and extremely bad service results; from the standpoint of the SQI's role in monitoring Verizon Maine's service quality we are more concerned with bad service results going undetected. The original SQI, for example, did not detect the instances – i.e., the specific wire centers – in 1999 and possibly earlier, where customers suffered the effects of significant congestion in access line termination units and umbilical trunks. The original SQI did not have a call blocking metric. The Commission learned of the congestion from customer complaints to the

[17] Verizon Maine provides about 85% of the access lines in the whole State; most of the rest are provided by independent ILECs in their own separate service areas. It follows that Verizon Maine provides a far higher percentage of access lines within its own service territory.

Consumer Assistance Division, which prompted our investigation into Verizon Maine's network management and monitoring practices in Docket No. 99-132.

The parties' comments on the SQI revisions suggested in the FNOI have been valuable. They have reminded us that the original SQI was designed to prevent systematic and widespread deterioration in Verizon Maine's service quality under the AFOR; we believe the SQI has succeeded in doing so. We agree with Verizon Maine that revisions to the SQI should not make it more complex, burdensome, and costly for the Company to function. With respect to the generic topics on which the FNOI requested the parties' comments, the revised SQI will not require separate urban-rural reporting, or additional separate residential-business customer reporting; it will not expand wire center-based reporting; it will not include "surveillance" performance levels or carrier-to-carrier (Verizon Maine-to-CLEC) wholesale service quality performance metrics. The revised SQI will retain the original SQI's baselines for existing metrics (the worst of the three years in the baseline period) and revise the method for establishing new baselines (the average of the last three years).[18] It will retain the customer rebate mechanism from the first phase of the AFOR, but will increase the maximum and per-metric rebate amounts.

We will study Verizon Maine's service quality reporting to the FCC to see if its residential-business and urban-rural performance results are significantly different. If they are, we will consider modifying the SQI. As for wire center-based reporting, we will require Verizon Maine to continue the network congestion reporting we ordered in Docket No. 99-132. The terminating and originating call blocking reports may be reduced to an "exception report" format, and all reports should use the Company's actual internal standard call blocking thresholds for line units, umbilicals, and trunks. We will require the Company to add "busy hour call blocking in switch module links" to its congestion reports.

1. The OPA's Recommended SQI

We will adopt the OPA's recommended Average Held Order Delay Days, Report Center Call Answering, and Repair Appointments Not Met metrics. These are metrics we also suggested in the FNOI. We will adopt the call blocking metric suggested in the FNOI, which will include the OPA's recommended "Umbilical Blockage" metric, but will also include the other sources of call blocking – line units, interoffice trunks, and switch module links.

We do not believe the OPA's Missed Installation Rate metric is necessary, as it overlaps the existing "Installation Appointments Not Met" metric.

We also do not believe it is necessary to add the OPA's recommended new Repair Busy Rate metric to the SQI. There is no evidence that

[18] As the parties recommended, we will take up carrier-to-carrier metrics and a financial penalty mechanism in our proceeding that we must conduct pursuant to 47 U.S.C. § 271.

customers have experienced a high busy signal rate when calling to report service troubles to Verizon Maine's repair center.

The OPA's recommended "Dial Tone Speed" metric for Host-Remote clusters is not necessary. Delayed dial tone has nothing to do with the host-remote cluster's umbilical trunk connections; dial tone is delayed when customers' line units at their serving switches are congested when they attempt to make calls. Thus, dial tone delay is an event that happens at a customer's local central office, not in the host-remote network.

We do not agree with the OPA's recommended new service reliability metrics for service outages and interoffice fiber and SS7 network failures. We especially do not agree with the magnitude of the financial penalties associated with those proposed metrics. The "Service Outage" metric in the original SQI, which is an adaptation of the comprehensive metric developed by the Network Reliability and Interoperability Council, covers all service outages and weights them according to the types of services that are lost, the number of access lines affected, and the duration of the outage. We agree with the OPA that the performance baseline for the "Service Outage" metric may have to be revised and will require Verizon Maine to update it for the revised SQI.

We agree with the reasoning behind the OPA's recommendation to increase the maximum customer rebate amount in the revised SQI, and we will increase it, but not to 4.5% of Verizon Maine's 2000 jurisdictional revenues, as the OPA recommends. For the original SQI we had set the maximum rebate amount, $11 million, at approximately 3.4% of Verizon Maine's 1995 revenues. We will apply that same percentage to the Company's 2000 revenues, which results in a maximum customer rebate of $12.5M, a 13.5% increase above the current maximum. We will also increase the maximum per-metric rebate amount by the same percentage, from $1M to $1.135M, and from $2M to $2.27M for the Service Outage metric.

2. <u>Commission Adopted SQI</u>

The Commission will adopt the SQI in Table 3. "TBD" (to be determined) means that Verizon Maine will provide data to the Commission as required below, in Section VII.E.6.

TABLE 3
REVISED Verizon Maine SQI

C = Changed metric N = new metric

PERFORMANCE METRICS	BASELINES
CUSTOMER SERVICE	
(C) 1. Premise Installations: % Appointments Not Met – Company Reasons	TBD
(C) 2. Mechanized Installations:% Appointments Not Met – Company Reasons	TBD
(N) 3. Premise Repairs:- % Appointments Not Met – Company Reasons	TBD
(N) 4. Mechanized Repairs: % Appointments Not Met – Company Reasons	TBD
(C) 5. Held Orders - Average Delay Days	TBD
6. Business Office calls: % Answered over 20 seconds	31
(N) 7. Repair Service Calls: % Answered over 20 seconds	TBD
SERVICE RELIABILITY	
8. Customer Trouble Reports Rate per 100 lines	1.08
(N) 9. Repeat Trouble Reports Rate per 100 lines	TBD
10. % Troubles not cleared within 24 hrs – Residential Customers	21.1
11. % Troubles Not Cleared within 24 hours - Business Customers	9.0
12. Dial Tone Speed % over 3 seconds	0.36
(N) 13. % Blocked Calls	TBD
(C) 14. Service Outage	TBD
CUSTOMER SATISFACTION	
(N) 15. PUC Complaint Ratio	TBD

3. New Metrics in the Revised SQI

a. Premise Repair Appointments; % Not Met on Time – Company Reasons

b. Mechanized Repair Appointment: % Not Met on Time – Company Reasons

Verizon Maine's performance in keeping repair appointments is just as important to its customers as its performance in keeping service installation appointments. We will measure Verizon Maine's performance in keeping its repair appointments both for repairs that require premise visits and repairs the Company can accomplish remotely, by its mechanized "flow-through" process. The Company's performance in keeping premise repair appointments is a particular concern: because Verizon Maine only promises the repair will be done sometime during the appointed day, the Company requires customers to be at the home or business all day.

c. Repair Service Calls: % Answered in over 20 Seconds

We believe this metric is as important to measure as Verizon Maine's Business Office call answering performance. As we have with the Business Office call answering metric, we will require Verizon Maine to restrict the Repair Service call answering metric to calls answered by a live person.

d. % Repeat Trouble Reports

"Repeat troubles" are recurring service problems customers report within 30 days of their initial trouble reports. Although the Troubles Not Cleared within 24 hours metric measures Verizon Maine's repair performance, it does not measure whether the repairs hold up; the % Repeat Trouble Reports metric does.

e. % Blocked Calls

This is a much-needed network congestion metric, which will measure terminating and originating call blocking during the busy hours of all sources of call blocking in Verizon Maine's network: access line termination units, umbilical trunks, interoffice trunks and links between switch modules.

f. PUC Complaint Ratio

As indicated in the FNOI, this metric is included in the NARUC's Service Quality White Paper metrics, and the OPA has recommended that we include it in the revised SQI. The original SQI lacked any metric that measured customer dissatisfaction with such services as billing, credit and collection, operator services, responses made to customers by Verizon Maine's business office, repair centers, and customer care centers. The "Complaint Ratio" will measure Verizon Maine's performance in dealing with these issues.

The OPA recommended that the Commission continue to measure and include customer satisfaction in the SQI, as measured by survey instruments and require Verizon to have an independent survey expert review the Company's practices in designing and gathering data to ensure that it is statistically valid. The OPA also recommended that we measure the rate at which Verizon's customers file complaints against the company for issues related to local service. The OPA based this recommendation on two events: the Commission's request to meet with the Company to discuss a recent surge in complaints; and the complaint filed by the Communications Workers of America (CWA) against Verizon's New York affiliate. The OPA stated that it is concerned that the types of data manipulation that are alleged in New York could occur here in Maine. For these two reasons, the OPA stated that "measuring the PUC Complaint Ratio will provide a backstop for such possible misconduct and serve as another tool for measuring overall customer satisfaction."

The OPA also recommended that the SQI be more heavily weighted to actual experiences between customers and Verizon Maine than can be measured with small sample customer surveys. We believe the "PUC Complaint Ratio" achieves this goal, because it is an objective measure that will not be influenced by a customer's mood at the time the survey is administered or by the way that a question may be posed.

We agree with the OPA that we should continue measuring customer satisfaction as part of a new SQI and that the PUC complaint ratio is a good measure of overall customer satisfaction. We therefore eliminate the four survey metrics relating to provisioning and maintenance used in the original SQI to measure customer satisfaction and replace them with the PUC complaint ratio.

The "PUC Complaint Ratio" will replace subjective measures (the surveys) with a more encompassing, objective measure. The surveys are the only metrics in the original AFOR that measured customer satisfaction with the Company's service. Yet these metrics examined only the Company's performance for provisioning and maintenance. Compounding this problem of limited performance scope, only a small sample of the residential and business customers that utilized Verizon Maine's provisioning and maintenance services was surveyed. The "PUC Complaint Ratio," on the other hand, will measure all the Company's services provided to all customers, from installations and repairs to billing and collections. Consequently, the "PUC Complaint Ratio" will capture areas of customer dissatisfaction that the provisioning and maintenance surveys would not. In addition, while we do not necessarily believe that Verizon Maine will experience the same problems as those alleged in New York by the CWA, the "PUC Complaint Ratio" nonetheless will address the OPA's concern of potential data manipulation by the Company by providing an objective measure of service quality that is outside of the Company's control.

In its Brief on Exceptions to the Examiner's Report, Verizon Maine opposes the inclusion of the complaint ratio in the SQI because the metric would be "far too subjective and unwieldy to convey accurate information on the level of

Verizon Maine's Service Quality." Verizon stated that complaints are frequently made on non-service quality issues such as Basic Service Calling Area limitations, line extensions, pole attachments, etc., and that many other complaints served on Verizon Maine do not relate to services it provides (e.g., interexchange carrier disputes).

We disagree. The "PUC Complaint Ratio" is a good indicator of the Company's overall service provided to customers. Customers who are not satisfied with the Company's service, whether it is repair service, installation service, or credit and collections service, may file a complaint against the Company. The number of complaints filed against the Company is, therefore, a reasonable indicator of overall customer dissatisfaction with the Company. In addition, the Complaint ratio is an indicator of the Company's quality of service provided to customers who contact the Company seeking assistance. Complaints are taken by the Commission only after the Company has been afforded an opportunity to address the customer's concern directly with the customer. If Verizon Maine fails to resolve the matter to the customer's satisfaction, the customer may then file a complaint against the Company with the Commission.

The Company argued that the Complaint Ratio is not a good indicator of service quality because many complaints are without merit. The Company provided no evidence, however, that the percentage of complaints in which it is found to be not at fault is likely to vary depending on the level of total complaints. Accordingly, it is likely that an increase in the total number of complaints is a reasonable indicator of an increase in service problems. More to the point, the Consumer Assistance Division (CAD) carefully considers the calls it receives to ensure that only complaints that have possible merit are accepted. For example, a customer must first attempt to resolve a dispute directly with the utility before the CAD will accept a complaint. In addition, the CAD does not accept complaints from customers regarding issues over which the Commission has no jurisdiction (e.g., interstate issues) or which the CAD has no ability to resolve (e.g., a complaint about an approved tariff rate). This is not to say that the CAD accepts complaints only where it is obvious that the utility is at fault; rather, the complaints are reviewed and accepted only after it is determined that the customer has complained to the utility, that the utility has had an adequate opportunity to resolve the matter, that the Maine PUC has jurisdiction, and that the CAD has the authority to resolve the dispute.

Verizon Maine argued that the inclusion of the "PUC Complaint Ratio" metric would amount to "double jeopardy" in that customers who are unhappy with its service would likely be included under another SQI measurement. While it is true that some customer complaints may be reflected in other metrics, many service quality areas for which customers have complaints would not, e.g., Verizon Maine's quality of service provided to customers who contact the Company seeking assistance. In addition, the same argument could be made regarding the provisioning and maintenance surveys that the PUC Complaint Ratio will replace. The surveys measured customer dissatisfaction with provisioning (installation) and maintenance (repair). Yet both installation and repair performance were also measured in the original

SQI by the "Installation - % Appointments Not Met" and "% Troubles Not Cleared Within 24 Hrs" metrics.

The complaint ratio will be expressed as the number of complaints filed against the Company per 1,000 customers. The ratio will be calculated using the number of complaints that are filed against Verizon Maine with the Commission in the 12-month period during which the SQI is measured. Both residential and business customer complaints will be included in the complaint ratio. Complaints will be defined as customer contacts to the Consumer Assistance Division (CAD) where the customer has a dispute that he or she has been unable to resolve with the Company, that appears to have merit, and that the CAD should resolve. This is the same definition that the CAD has used in the past. Customers who contact the CAD who have not previously contacted the Company are referred to the Company.

All complaints filed against Verizon Maine will be included in the PUC Complaint Ratio. The OPA recommends that only complaints involving "local service" be included in the ratio calculation. We disagree. The CAD receives a significant number of complaints involving Verizon toll service and billings. In addition, Verizon provides toll service to a large percentage of its local exchange customers and complaints are not always easily separated into “local” and “toll” components. Moreover, historical complaint numbers used to calculate the recommended baseline include complaints involving all of Verizon Maine's services. To differentiate local service complaints from other complaints on an ongoing basis would not only involve a significant effort, but would also require a similar differentiation of historical data (necessary to establish the correct baseline for a local service only metric) that would be difficult, if not impossible.

4. <u>Changed Metrics in the Revised SQI</u>

These “changed” metrics are modifications of metrics in the original SQI.

a. <u>Premise Installations - % Appointment Not Met on Time – Company Reasons</u>

b. <u>Mechanized Installation - % Appointments Not Met or Time – Company Reasons</u>

These metrics are refinements of the Installations Not Met metric in the original SQI. We will require Verizon Maine to measure its premise and mechanized installation performance separately. As with repair appointments, the Company’s performance in keeping premise installation appointments is a particular concern because the Company only promises service will be installed sometime during the appointed day, potentially requiring customers to be at the home or business all day.

c. Held Orders – Average Delay Days

This metric will measure the number of "delay days" between customers' promised installation dates and the dates the installations are actually completed, averaged over all customers with orders delayed for Company reasons. The Held Order metric in the original SQI measured the average annual total delay days, which is difficult to understand and to relate to how long Verizon Maine's customers with delayed orders are being made to wait for service. We therefore replace it with the revised calculation.

d. Service Outage

We will update the baseline for this metric. Our reasoning is explained in Section VII.E.6 (Performance Baselines) below.

5. The Customer Survey Metrics

The original SQI has four metrics that measured, through small sample monthly surveys by a Verizon vendor, residential and business customer dissatisfaction with Verizon Maine's service provisioning and repair performance. We have eliminated these metrics because we doubt that the survey sample size is adequate or that the survey process itself is sufficiently objective and consistently conducted from one interviewer to another.[19] For these reasons, we have not placed a great deal of weight on these sample survey-based metrics. We believe both the old and new metrics in the revised SQI cover customer dissatisfaction with Verizon Maine's provisioning and repair performance more thoroughly and more objectively than the sample survey-based metrics. In particular, the CAD Complaint Ratio measures Verizon Maine's performance in these and all other areas. We note that Verizon provides the FCC customer satisfaction survey data as a condition of its approval of the Bell Atlantic-GTE merger; thus, we will be able to monitor that data.

6. Performance Baselines

Verizon Maine believes the purpose of a revised SQI and its performance baselines should be the same as it was for the original SQI: to ensure that

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[19]According to Verizon Maine's comments on the FNOI, the survey is based on approximately 50 Verizon Maine customers per month who have had service installed or repaired. Although that amounts to an annual sample size of 600, it is actually only 150 per metric, which we do not believe provides either an adequate level of statistical confidence or a small enough margin of error. During hearings the bench asked Verizon Maine's service quality witness, Linda Thoms, to provide evidence that the month-to-month survey data are not correlated (which would allow the monthly data to be pooled and treated as a single sample). Ms. Thoms responded to the question in a data response. It provided no evidence, and instead seems to indicate there *is* month-to-month, serial correlation in the survey data, which means the monthly data should not be pooled.

Verizon Maine's service levels under the AFOR would not deteriorate from the levels achieved prior to that time under rate of return regulation. Therefore, the performance baselines should not be changed from those in effect during the original AFOR. The OPA believes the performance baselines should reflect Verizon Maine's historical performance and be based on a review of the degree of variability in it and any trends in recent performance.

We agree with the OPA. We are particularly concerned that we not adopt baselines that reflect declines in Verizon Maine's performance. Accordingly, in its compliance filing to this order, we will require Verizon Maine to provide monthly service quality data for the new and changed metrics in the revised SQI for the years 97-98, 98-99, and 99-2000;the baselines for these metrics will be set at Verizon Maine's average annual performance levels for those three years. For the metrics that are unchanged from the original SQI, we will retain their existing baselines.

We will not change the Dial Tone Speed metric's baseline of .36% to .1%, as the OPA recommended. We agreed to increase the original 0.04% baseline in annual steps to the current level because of the Internet's impact on Verizon Maine's network, and to prevent the Company from making line unit investments just to maintain the 0.04% performance level so as to avoid paying penalties. Verizon Maine's response to a bench data request shows that the current 0.36% baseline is the lowest DTS baseline in Verizon's national service territory.

We will update the Service Outage metric's baseline based on its most recent 3-year performance. Because of the state-wide toll isolation caused by the Verizon Maine outages in Freeport in 1995 and Topsham in 1996, we added this metric to the SQI in the 97-98 SQI reporting year primarily as an incentive to Verizon Maine to create more physical route diversity in its interoffice network, which it has accomplished with the construction of its service territory-wide "self-healing" SONET rings. We believe the performance baseline for the Service Outage metric should reflect the effects of Verizon Maine's high-performance interoffice network on its outage performance.

Regarding the new % Blocked Calls metric's baseline, the FNOI noted that 3% is the recommended busy hour-based call blocking standard in NARUC's Model Telecommunications Service Rules. Verizon Maine's comments on the FNOI indicated this level would be reasonable as a wire center-based standard. We therefore adopt, as the baseline for the % Blocked Calls metric, the lower of 3% or, the average of the monthly percentages of blocked calls data over the last three years.

7. <u>Reporting</u>

We will require Verizon Maine to file SQI reports monthly. The Company should continue filing reports pursuant to the metrics in the original SQI metrics until we adopt baselines for the new and changed metrics in the revised SQI.

8. Other OPA Service Quality Recommendations

a. The OPA recommends the Commission order Verizon Maine to send its customers an annual service quality report. We will not order Verizon Maine to do so. We will require Verizon Maine to continue placing on any customer bills containing service quality rebates the notation: "REBATE FOR BELOW-STANDARD SERVICE QUALITY" next to the rebate amount. As under the current AFOR, if the annual penalty exceeds $750,000, the Company shall provide the rebates to customers in equal credits in 12 monthly bills.

b. The OPA recommends that the Commission order Verizon Maine to compensate customers when it misses repair appointments or service installation dates for Company reasons by providing affected customers with a fixed amount or a waiver of charges. We will not require Verizon Maine to implement such a procedure, because the Company will be subject to paying customer rebates in the revised SQI for failing to meet the baselines of two installation and two repair performance metrics.

c. The OPA recommends the Commission order Verizon Maine to make customer rebates automatic in its tariffs when local service and other services are interrupted beyond specific lengths of time. To receive such rebates, Verizon Maine's tariff require customers to bring service outages to its attention within ten days of the outage. In its exceptions to the Examiner's Report, Verizon Maine said it does not know if customers lose service until they report it to Verizon-New England's Repair Center. If customers do so (and do so within 10 days of the outage) and the lengths of their outage durations meet the tariff, the Company asserts the rebates are already automatic; those customers do not have to request them.

It is unlikely that very many customers would be aware of the existence of the tariff provisions, the rebates or the requirement to request them within 10 days of the outages. Furthermore, based on outage reports Verizon Maine files pursuant to Chapter 200 of our rules, we are aware that outages can affect all customers in entire wire centers. In such instances of wide-spread outages, it is not necessary for *all* customers in the affected wire centers to call its Repair Center for the Company to know they have lost service and the length of time they have lost it. Therefore, for any outage the Company knows of – by whatever means – and knows which customers it affected, if the outage duration meets the tariff, the Company should provide rebates to those customers automatically. Such customers should not have to bring the outage to Verizon Maine's attention within 10 days of the outage to qualify for rebates. In its compliance filing to this Order, Verizon Maine should revise its tariff accordingly.[20]

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[20]Verizon Maine's tariff indicates that basic exchange service must be interrupted for "over 24 hours" to qualify for a rebate, and the rebate is only 1/30 of the monthly rate times the duration of the outage (in days). Two points are relevant here: (1) the Commission's outage records show Verizon Maine outages lasting over 24 hours to be extremely rare events; and (2) a residential customer's rebate for being without basic

VIII. VERIZON INVESTMENT LEVELS IN MAINE

The Executive Branch (EB) agencies have proposed that the Commission establish a benchmark that compares technology deployment in Maine's service center communities with that deployed in the Route 128 region of Massachusetts or throughout the nation. The EB agencies also support a moderate increase to basic rates to encourage continued investment by the Company in Maine.

The OPA argues that the Commission should reject the EB proposals because: 1) economic theory suggests that new investments should be made on the basis of the expected return on the particular investment, not the overall expected return in the jurisdiction; and 2) the Commission should not put itself in a position of encouraging investment that might ultimately turn out to be unprofitable, and lead to Verizon seeking additional rate increases as compensation. Further, the OPA asserts that the Company's actual or implied threats to invest less in Maine, unless it receives favorable treatment on its request for higher basic service rates, are both "hollow and inappropriate." The OPA further states that giving credence to such threats will encourage them in the future. The OPA argues that such encouragement would permit Verizon to initiate a type of bidding war among jurisdictions, with each one seeking to get Verizon to invest by offering the highest return. Finally, the OPA states that while it shares the EB's hope that investment in telecommunications infrastructure in Maine will be vibrant and competition will develop, the OPA believes that the EB has proposed the wrong means and the wrong investor to achieve that worthwhile goal. The OPA asserts that the policy objective in Maine should be to allow the competitive marketplace to decide what services are offered and by whom.

The Commission has the responsibility to enforce all provisions of the statutes governing telecommunications in Maine, and encouraging the deployment of advanced services is established as a policy goal in both § 7101(2) and § 9103 (4). Nevertheless, the Commission must balance that objective against other statutory goals that may appear to have competing purposes, such as the promotion of universal service, the provision of service throughout the state at reasonably comparable rates and maintaining local rates at as low a cost as possible. The Commission has also expressed its desire to encourage the development of economic competition throughout the State.

While we share the intent stated by both the EB and the OPA that telecommunications infrastructure and the services offered in Maine should be as good or better than those offered in other jurisdictions, we do not believe that Verizon should be given any special incentives to invest in the State beyond those that it receives from our implementation of incentive regulation in general. Our policy remains that competition should determine the level of investment and the selection of investors in

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service for as long as a day-and-a-half would be less than a dollar. Thus, it is unlikely that the tariff changes we require will have a noticeable financial effect on Verizon Maine.

the telecommunications market, and that competition should be fair and open (a “level playing field”), as provided for in various sections of state and federal law. The current and revised AFORs both give Verizon full pricing flexibility on new or advanced services, to the extent permitted under applicable laws or FCC rulings, and the opportunity to realize fully the rewards that sound investments will bring. Only in the areas of basic service for residential and small business customers, operator services and directory assistance will we constrain Verizon’s ability to raise its prices, and we do so because we find that workable competition does not exist at this time in the markets for those services. We also share the concern raised by the OPA that the Commission should be reluctant to designate any particular investment or technology for the underserved areas of Maine. Such a course would, in our view, place substantial and arguably unwarranted risk on ratepayers.

Despite our view that, in general, competition should control the type and amount of investment in the telecommunications industry in Maine, Verizon, as an ILEC, has certain obligations to maintain a level of service that is acceptable to the Commission throughout its service territory. Generally, the maintenance-of-service obligations apply only to those services considered essential or basic, but the individual services included in that category may change over time. There also may be circumstances in which the Commission or other State agencies may wish to encourage the placement of a particular type of infrastructure or the offering of new or advanced services that would not otherwise be made or offered under a purely economic decision. Those steps should be taken only after an examination of all alternatives and ramifications. If necessary in the future, we may further investigate and analyze this issue.

Dated at Augusta, Maine, this 25th day of June, 2001.

BY ORDER OF THE COMMISSION

____
Dennis L. Keschl
Administrative Director

COMMISSIONERS VOTING FOR: Welch
Nugent
Diamond

CONCURRING OPINION OF CHAIRMAN WELCH

I concur with the Commission's decision to offset the decrease in access revenues caused by the operation of the access parity statute, 35-A M.R.S.A. § 7101-B. I also agree with the reasons for that decision stated in the Commission's Order. In particular, I agree that the access parity statute allows us to override any statutory directive that might be interpreted to restrict our authority to raise basic rates and that constitutional and other statutory requirements in some circumstances may compel us to allow increases in basic rates.

In this concurring opinion, I address an argument presented by the Public Advocate. The OPA opposed any increase in basic rates, relying in part on the admonition in 35-A M.R.S.A. § 7303(2) that rates for "traditional flat rate local telephone service" be "as low . . . as possible." The OPA's reliance on § 7303 is misplaced. First, Section 7303(2) has *never* meant that the Commission should sacrifice all other rate design objectives for the benefit of basic monthly rates. In fact, § 7303 as a whole refers narrowly to the issue of whether the Commission should encourage (or even permit) the use of local *measured* service as an alternative to flat-rated service. *See* § 7303(1). Read in context, the "as low . . . as possible" language means only that the Commission may not inflate the price of flat-rated service to levels that would stimulate migration to "optional" measured service. This interpretation is confirmed by § 7303(3), which sets forth, as the test for whether the Commission has complied with § 7303(2), whether more than ¾ of basic service customers purchase flat rate service. Put another way, § 7303(2) constrains the relationship between basic flat rate and basic measured rate – it does not suggest any relationship between the rates for basic and any other services, such as access or toll.

I recognize that in *Public Utilities Commission, Investigation into New England Telephone Company's Cost of Service and Rate Design,* Docket No. 92-130, we interpreted the "lowest possible rate" provision as imposing a separate requirement from the provisions restricting measured service. I also recognize that the Order in Docket No. 92-130, as well as the first AFOR Order in Docket No. 94-123, we interpreted the provision as a rate design directive limiting the circumstances when local rates could be increased to "circumstances each of which in effect amounts to a finding that an existing rate design is unreasonable and detrimental to overall rate levels or to the public interest." *First AFOR Order* at 9. My present view, however, is that the rulings in those cases are incorrect, and if it were necessary to address those rulings in a future case, I would consider overruling them.

NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of review or appeal of PUC decisions at the conclusion of an adjudicatory proceeding are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 1004 of the Commission's Rules of Practice and Procedure (65-407 C.M.R.110) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which reconsideration is sought.

2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within 30 days of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320(1)-(4) and the Maine Rules of Appellate Procedure.

3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320(5).

Note: The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.